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The time-bomb at the heart of Europe

A 14-PAGE SPECIAL REPORT ON FRANCE

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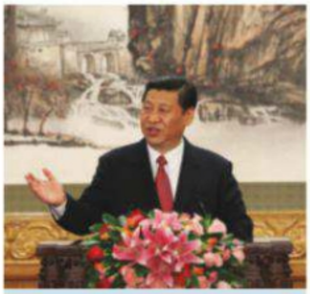

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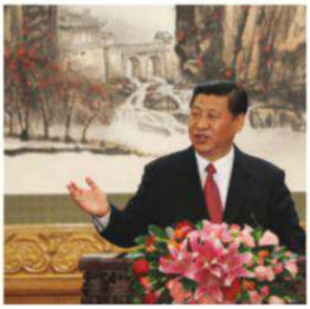
Politics



Xi Jinping officially took over from Hu Jintao as secretary-general of the Communist Party of **China**. Mr Xi and the party's new seven-man Politburo standing committee were presented to the world's press a day after the end of the 18th party congress in Beijing. In his first speech Mr Xi accepted that China faces "severe challenges".

Yoshihiko Noda, **Japan's** prime minister, all but called a general election for December 16th over the objections of some of his colleagues in the ruling Democratic Party of Japan. He promises to dissolve parliament, but even his supporters think an election will hand power to the opposition Liberal Democratic Party, led by Shinzo Abe, a former prime minister.

Japan's GDP shrank by 0.9% in the third quarter, adding to worries that the world's third-largest economy could be heading back into recession.

Ban Ki-moon, the UN secretary-general, said an internal report on the organisation's failure to protect civilians during **Sri Lanka's** civil war will have "profound implications" for its future operations. The damning study was critical of the role of various UN agencies in the last months of the conflict, which killed perhaps 130,000 people.

History catches up

Brazil's Supreme Court sentenced José Dirceu, who was chief of staff during the government of Luiz Inácio Lula da Silva, to almost 11 years in prison after his conviction last month in a trial concerning a vote-buying scheme in Congress. Mr Dirceu is appealing against the verdict, which he claims is politically biased and a retaliation by the establishment for his days as a leftist rebel in the 1970s.

Mexico's Congress passed a big reform to the country's labour market that sweeps away many archaic laws and makes it easier for employers to sack workers. The act is a big achievement for the outgoing president, Felipe Calderón. His successor, Enrique Peña Nieto, supported the bill.

The cauldron burns

Ahmad Jabar, the head of the military wing of **Hamas**, the Palestinian Islamist group that runs Gaza, was killed in an Israeli air strike. Shin Bet, the Israeli security service, said it had carried out the attack, claiming that he was responsible for all terrorist actions launched from Gaza in the past decade. Three Israelis died when a barrage of rockets were launched from Gaza in revenge.

The **Palestinians** said they would formally apply for enhanced observer status at the United Nations during a meeting of the General Assembly on November 29th; a large majority is likely to say yes. **Israel**, backed by the United States, objected, saying that the move would make direct negotiations harder.

Two foreign workers were killed and a third injured in a series of bomb blasts in **Bahrain**. The official news agency blamed terrorists for the attacks. The Gulf state has been wracked by unrest since February 2011. In a separate case, a court jailed two online activists accused of "defaming" the king on Twitter.

Increases in fuel prices after the government decided to do away with subsidies sparked demonstrations and calls for a general strike in the **Jordanian** capital, Amman, and other cities. In a rare show of open anger at the monarchy, protesters specifically criticised King Abdullah.

The African Union endorsed a decision by the Economic Community of West African States to send troops into **Mali** against Islamist extremists who have taken over the country's north.

Turkana tribesmen in north-western **Kenya** killed at least 42 policemen in an ambush, following a dispute about hundreds of cattle that were stolen from the neighbouring Samburu tribe. The episode stirred anxiety in the run-up to a general election next year, when ethnic tensions are bound to run high.

Tainted love

David Petraeus's resignation as director of the CIA because of an affair made the gossip columns as well as the front pages. General Petraeus took the job following his stint as commander of coalition forces in Afghanistan. The affair was uncovered by the FBI. As more revelations about its investigation emerged, General John Allen, General Petraeus's successor in Afghanistan, became mired in the scandal.

California auctioned the first permits in its emissions-trading system, six years after it was passed into law. The state's cap-and-trade scheme, the biggest in the United States, requires industrial companies to bid for permits to emit carbon, the amount of which is capped to reduce emissions. Business groups say it is a tax.

After Barack Obama's re-election victory, negotiations began in earnest between the White House and congressional Republicans over how to avoid the looming **fiscal cliff**. Glenn Hubbard, a senior economic adviser to Mitt Romney's campaign, opined that the Republicans should accept an increase in the average tax take from the rich as part of a deficit-reducing deal.

The politics of the barricade

The **euro zone** saw a wave of anti-austerity strikes and protests, with the most vociferous being in the worst-hit Mediterranean countries. Most forecasters expect GDP to shrink and unemployment to rise yet again next year.

France's president, François Hollande, insisted in his first big press conference that "decline is not our destiny" and asked to be judged on the state of his country in five years' time. His popularity rating has fallen faster than that of any other modern French president.

Mr Hollande also announced that France would recognise the opposition Syrian National Coalition as the future government of **Syria**, becoming the first big Western country to take such a step.

The director-general of the **BBC** resigned in the wake of the Jimmy Savile sex-abuse scandal and a TV programme that led to the erroneous identification of a Tory peer as a sex abuser. Several other senior BBC executives stepped aside, but Lord Patten, the chairman of the BBC Trust, insisted that he would stay on.

After weeks of rain, disastrous floods swept across **Italy**. Some 70% of Venice, including St Mark's Square, was inundated, prompting new concerns about the city's future.

Business

America could pass Saudi Arabia and Russia to become the world's biggest **oil producer** by 2020, according to the International Energy Agency's annual report. It could even become self-sufficient in energy by 2035, as oil and gas output soars because of the boom in fracking shale. The IEA reckons that the world's energy map "is being redrawn by the resurgence of oil and gas production in the United States".

BP and the authorities in America were close to a settlement over the energy company's criminal liability for the Gulf of Mexico oil spill in 2010. The agreement will need to be approved by a federal court.

Greens see red

The European Commission decided to suspend for a year the start of a controversial scheme to charge airlines for **carbon emitted from flights** to and from Europe. The policy has done something the UN can only dream of: it has united America, Russia, China, India and a host of other countries in opposition to it. The commission is suspending the charge in order to encourage talks on setting up a global system to regulate aviation emissions that will begin soon at the UN International Civil Aviation Organisation.

SAS, an airline that is half-owned by the Swedish, Norwegian and Danish governments, urged its employees to accept a package of redundancies, wage cuts and reduced pensions, or else it would be the "final call" for the company, which was founded in 1946. As with other flag carriers, SAS has had a bumpy ride competing with nimbler low-cost airlines, such as Norwegian Air Shuttle, which in January placed the largest ever order for new jets in Europe.

Lufthansa, Germany's biggest airline, reached a deal on pay and conditions with flight attendants, ending a dispute that disrupted its global services during the summer.

Apple and HTC, which is based in Taiwan and one of the world's biggest makers of **smartphones**, resolved all their outstanding legal issues over patents by entering into a ten-year licensing arrangement. It is the first patent dispute Apple has settled with a handset-maker that uses the Android operating system (HTC also sells devices that run on Microsoft's software).

Grin and bear it

Apple's share price continued its rapid descent from its mid-September peak of $702. Since then it has fallen by 23%, in part because of production and quality problems in Chinese factories that have beset the new iPhone 5. Around $150 billion has been wiped off Apple's market capitalisation.

Steven Sinofsky, who headed **Microsoft's Windows** division, abruptly left the company. No reason was given for his departure, leading to speculation that it was somehow related to the release of Windows 8, the latest version of the firm's operating system which has garnered mixed reviews. Mr Sinofsky is the second high-profile executive to leave a big tech company in as many weeks, following Apple's defenestration of Scott Forstall.

Vodafone booked another big write-down on its business in southern Europe, this time writing off £5.9 billion ($9.4 billion) at its Spanish and Italian divisions. The world's second-biggest mobile-phone operator, which is based in Britain, has now written down £24 billion over the past five years, mostly because of poor returns from the euro zone. But its stake in America's Verizon Wireless is paying off; it produced a £2.4 billion cash dividend for Vodafone this week.

Jefferies, a global securities firm, relinquished its claim to be America's largest independent bank by agreeing to a takeover by Leucadia, a conglomerate that holds around 30% of the company. Jefferies came through the financial crisis relatively unscathed. However, some investors are concerned about the health of its balance-sheet.

Credit-rating agencies came under more fire, this time in Italy, where prosecutors from the town of Trani asked a judge to order seven employees from Standard & Poor's and Fitch to stand trial for allegedly violating market rules when they announced downgrades on Italian sovereign debt. The two-year investigation was sparked by complaints from consumer groups and involved a police raid on the companies' offices in Milan. The employees haven't been charged. S&P dismissed the allegation as "baseless".

Quality broadcasting

In a week when another editorial scandal at the BBC prompted questions about the British broadcaster's future, **ITV**, one of its main commercial rivals, reported strong earnings. ITV was buoyed by a 20% rise in revenue at its film studio, which produces "Downton Abbey" and "Hell's Kitchen". Its share price skipped to a five-year high.

Other economic data and news can be found on pages 84-85


OVER THE PAST 10 YEARS WE'VE BUILT
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ECONOMY


SODA

The time-bomb at the heart of Europe

Why France could become the biggest danger to Europe's single currency

THE threat of the euro's collapse has abated for the moment, but putting the single currency right will involve years of pain. The pressure for reform and budget cuts is fiercest in Greece, Portugal, Spain and Italy, which all saw mass strikes and clashes with police this week (see page 51). But ahead looms a bigger problem that could dwarf any of these: France.

The country has always been at the heart of the euro, as of the European Union. President François Mitterrand argued for the single currency because he hoped to bolster French influence in an EU that would otherwise fall under the sway of a unified Germany. France has gained from the euro: it is borrowing at record low rates and has avoided the troubles of the Mediterranean. Yet even before May, when François Hollande became the country's first Socialist president since Mitterrand, France had ceded leadership in the euro crisis to Germany. And now its economy looks increasingly vulnerable as well.

As our special report in this issue explains, France still has many strengths, but its weaknesses have been laid bare by the euro crisis. For years it has been losing competitiveness to Germany and the trend has accelerated as the Germans have cut costs and pushed through big reforms. Without the option of currency devaluation, France has resorted to public spending and debt. Even as other EU countries have curbed the reach of the state, it has grown in France to consume almost 57% of GDP, the highest share in the euro zone. Because of the failure to balance a single budget since 1981, public debt has risen from 22% of GDP then to over 90% now.

The business climate in France has also worsened. French firms are burdened by overly rigid labour- and product-market regulation, exceptionally high taxes and the euro zone's heaviest social charges on payrolls. Not surprisingly, new companies are rare. France has fewer small and medium-sized enterprises, today's engines of job growth, than Germany, Italy or Britain. The economy is stagnant, may tip into recession this quarter and will barely grow next year. Over 10% of the workforce, and over 25% of the young, are jobless. The external current-account deficit has swung from a small surplus in 1999 into one of the euro zone's biggest deficits. In short, too many of France's firms are uncompetitive and the country's bloated government is living beyond its means.

Hollande at bay

With enough boldness and grit, Mr Hollande could now reform France. His party holds power in the legislature and in almost all the regions. The left should be better able than the right to persuade the unions to accept change. Mr Hollande has acknowledged that France lacks competitiveness. And, encouragingly, he has recently promised to implement many of the changes recommended in a new report by Louis Gallois, a businessman, including reducing the burden of social charges on companies. The president wants to make the labour market more flexible. This week he even talked of the excessive size of the state, promising to "do better, while spending less".

Yet set against the gravity of France's economic problems, Mr Hollande still seems half-hearted. Why should business believe him when he has already pushed through a string of leftish measures, including a 75% top income-tax rate, increased taxes on companies, wealth, capital gains and dividends, a higher minimum wage and a partial rollback of a previously accepted rise in the pension age? No wonder so many would-be entrepreneurs are talking of leaving the country.

European governments that have undertaken big reforms have done so because there was a deep sense of crisis, because voters believed there was no alternative and because political leaders had the conviction that change was unavoidable. None of this describes Mr Hollande or France. During the election campaign, Mr Hollande barely mentioned the need for business-friendly reform, focusing instead on ending austerity. His Socialist Party remains unmodernised and hostile to capitalism: since he began to warn about France's competitiveness, his approval rating has plunged. Worse, France is aiming at a moving target. All euro-zone countries are making structural reforms, and mostly faster and more extensively than France is doing (see pages 23-24). The IMF recently warned that France risks being left behind by Italy and Spain.

At stake is not just the future of France, but that of the euro. Mr Hollande has correctly badgered Angela Merkel for pushing austerity too hard. But he has hidden behind his napkin when it comes to the political integration needed to solve the euro crisis. There has to be greater European-level control over national economic policies. France has reluctantly ratified the recent fiscal compact, which gives Brussels extra budgetary powers. But neither the elite nor the voters are yet prepared to transfer more sovereignty, just as they are unprepared for deep structural reforms. While most countries discuss how much sovereignty they will have to give up, France is resolutely avoiding any debate on the future of Europe. Mr Hollande was badly burned in 2005 when voters rejected the EU constitutional treaty after his party split down the middle. A repeat of that would pitch the single currency into chaos.

Too big not to succeed?

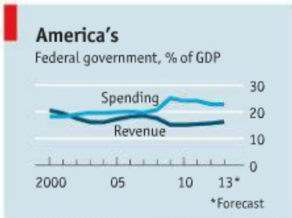
Our most recent special report on a big European country (in June 2011) focused on Italy's failure to reform under Silvio Berlusconi; by the end of the year he was out—and change had begun. So far investors have been indulgent of France; indeed, long-term interest rates have fallen a bit. But sooner or later the centime will drop. You cannot defy economics for long.

Unless Mr Hollande shows that he is genuinely committed to changing the path his country has been on for the past 30 years, France will lose the faith of investors—and of Germany. As several euro-zone countries have found, sentiment in the markets can shift quickly. The crisis could hit as early as next year. Previous European currency upheavals have often started elsewhere only to finish by engulfing France—and this time, too, France rather than Italy or Spain could be where the euro's fate is decided. Mr Hollande does not have long to defuse the time-bomb at the heart of Europe. ■

America's taxes

Higher taxes the easier way

Setting a cap on deductions is a better starting point than raising tax rates



AMERICA'S presidential election was supposed to be a head-clearing referendum on the size of government. It was not: voters split their vote, giving Barack Obama a second term and Republicans in the House of Representatives another big majority. Yet in one respect the election has clarified matters. Mr Obama has long argued that repairing America's finances will require raising more tax as well as cutting spending. Influential Republicans, most importantly including John Boehner, the Speaker of the House, now appear to agree.

This comes not a moment too soon. In less than two months America will reach a "fiscal cliff", when George W. Bush's tax cuts will expire and automatic spending cuts will take effect (see page 28). The economy could suffer a fiscal tightening of as much as 5% of GDP over a full year, easily enough to bring on recession.

Before any deal to avoid this can be struck, though, big issues must be resolved. What categories of spending are to be cut? And, on the revenue side, which taxes should go up? Ever since taking office, Mr Obama has pressed to make Mr Bush's tax cuts permanent for 98% of households while ensuring that the wealthiest 2% pay more. Mr Boehner says that tax rates should not go up for anyone; but he is open to raising revenue by eliminating tax breaks. The good news is that there may be a deal to be had that meets both objectives.

Returning the two top marginal rates to 36% and 39.6% from their current 33% and 35% would hardly capsize the economy, but it is not the most efficient way to raise revenue. At the margin, higher rates discourage work and investment and encourage tax avoidance. It would be better to revamp the tax code, starting out by leaving marginal rates alone and instead raising revenue by curbing the deductions and exemptions that pockmark the system and cost the Treasury as much as $1 trillion a year in forgone revenue. These "tax expenditures" are camouflaged government subsidies and create damaging distortions: the mortgage-interest deduction, for instance, encourages supersized houses and debts to match; the charitable deduction forces taxpayers to subsidise everyone else's pet cause, whether that be Planned Parenthood or the George W. Bush presidential library; and the tax break for employer-provided health insurance helps fuel the relentless rise in health-care costs.

Cap in hand

There are many routes to reforming these exemptions. One would be to single out particular tax breaks for elimination. But the likelihood is that the process would crumple under the onslaught of lobbyists who defend every loophole, resulting in too many exceptions and too little revenue. An easier first step would be to cap all deductions, an approach advanced by none other than Mitt Romney. Set at $50,000 such a cap would raise some $750 billion over ten years, estimates the Tax Policy Centre, a think-tank—more than would be obtained by restoring the top two rates to pre-2001 levels. The cap would barely touch the bottom 60% of taxpayers while only slightly hurting the upper-middle class. Most of the money would come from the top 1%. If such a cap were agreed to now but did not take effect until 2014, that would allow time for charities, employers and others to plan—and for the details to be tweaked as part of a bigger deal also involving much bigger spending cuts, especially to the huge unaffordable entitlement programmes.

The overall target is to save $4 trillion over the next ten years. Mr Obama is still sticking to the idea that $1.6 trillion of that should come from higher tax revenues and he is still focusing on raising rates. That may be a negotiating tactic, but it would be much better if he began with the deductions. ■

The BBC

Picking up the pieces

Why Britain's public broadcaster got into a mess, and how to reform it

IT IS a measure of the remarkable nature of the BBC that its director-general, George Entwistle, was finally driven from the job he had only recently acquired by one of the corporation's interviewers. He had just about survived revelations that a celebrated, recently deceased, presenter had been using his position to abuse children, and that "Newsnight", a current-affairs programme, had shelved an investigation into the scandal; he might have held on in the wake of the broadcast of an item wrongly accusing a former senior Conservative politician of child abuse (without even a cursory check of the evidence). But the loss of confidence in him following a devastating interrogation by John Humphrys on the "Today" morning radio programme on November 10th did for him.

Mr Entwistle's departure, however, should not obscure the real issue lying behind the BBC's difficulties. In his fumbling radio performance, he put his finger on the problem. "The organisation is too big," he admitted. Britain needs to reform the way it runs public-sector broadcasting, and that insight should inform the process.

The BBC has long dominated Britain's media, but in recent years it has got even bigger, both absolutely and relatively. Many serious broadsheet and local newspapers are dying. ▸▸

Tabloid newspapers have been shamed by a phone-hacking scandal, and are likely to endure stricter oversight in future (see Bagehot). The corporation gets £3.6 billion ($5.7 billion) a year from a licence fee levied on every household that watches television, and is therefore invulnerable to the vagaries of the media market, while the technological change that has caused other media outlets to shrivel has given the BBC new scope for expansion. It has a huge online presence and a proliferation of digital television channels and radio stations. With a staff of around 23,000, it is the largest broadcaster in the world.

The BBC makes good use of some of this money. Its documentaries, serious radio output (such as "Today") and website are excellent. Although polls show trust in it is declining, the reputations of other great British institutions, such as Parliament and the City, have fallen further still. The BBC remains respected around the world and is a handy tool for projecting British interests—cheaper and cleaner than bombs.

Yet Britons' attention has drifted to other entertainments. The BBC's share of British viewing time has dropped from over a half three decades ago to under a third today as pay-television and free multichannel services have grown. Britons have noticed. According to a YouGov survey in 2010, 60% regard the licence fee as poor value for money. And the decline of private-sector media outlets raises questions about the impact of the BBC's public subsidy. The *Guardian*, for instance, might make a go of being a British-based global online, leftish news provider, were it not for the state-funded competition.

Forget the fripperies

The BBC's size, as Mr Entwistle pointed out, is a problem not just for the competition but for the organisation itself. Its bloated management means that those at the top do not know what's going on at the bottom, and stunts creativity (see page 54). Few of its dramas or comedies are world-beaters ("Downton Abbey", a current hit, is made by an American-owned independent studio and broadcast on ITV). Even in news, recent big stories, such as phone-hacking and MPs' expenses, have been broken by impoverished newspapers, not the sluggish state-backed monolith. Editors should edit—and be responsible for it—not report to compliance officers.

The radical solution would be to get rid of a lot of the BBC. Public broadcasting should focus on areas where the market does not provide—expensive things such as investigative journalism and foreign reporting, serious radio, some areas of arts and science broadcasting—and forget about the prime-time entertainment shows and sports where the BBC spends taxpayers' money bidding up stars' wages. A smaller, more focused organisation would find it easier to take risks and innovate.

The BBC's defenders say that, without popular fodder like "Strictly Come Dancing", audiences would shrink, and the licence fee become impossible to defend. It probably would; and a good thing too, since it is a regressive tax. Public-service broadcasting should be paid for by the Treasury, through a long-term grant made by a self-perpetuating independent body that kept it at arm's length from politicians.

A better objection to a complete overhaul now is that politicians have no appetite for such a radical solution, and the BBC needs a set of fixes quickly. One useful change would be to split the job of director-general into those of chief executive and editor-in-chief. The first would be a manager, charged with making the monolith more efficient; the second would be a journalist, charged with producing accurate, hard-hitting stories—and refocusing the output on quality.

Britons are naturally resistant to radical ideas. As the 20th century showed, that is, by and large, a good thing. The danger, though, is that unreformed organisations wither and die, or implode. The media business is one of Britain's strengths. If it is to stay that way, the BBC needs to change. ■

China's new leaders

Time to choose

Will the new line-up at the top of the Communist Party take the radical approach that is needed?

THERE was no ticker tape and there were no hugs on November 15th when Xi Jinping stepped out onto the red carpet in the Great Hall of the People. Mr Xi had just been "elected" as general secretary at the party's 18th congress (see page 43), the role for which he was anointed five years ago. The appointment of his deputy, Li Keqiang—an economist and protégé of the outgoing party chief, Hu Jintao—was also foreseen.

The nature of elite political power has changed since the days of Mao Zedong. His word was law and he led China into chaos. After Mao, Deng Xiaoping saw that economic reform was China's salvation. The next two generations of Chinese leaders—Jiang Zemin, the party chief from 1989 to 2002, and Mr Hu—continued economic reform but saw their own power decline as the influence of interest groups within the party grew. Mr Xi now inherits their problem. Leaders of state-owned enterprises, senior army figures and former leaders (including Mr Jiang and now Mr Hu) will all push their interests directly or through their proxies on China's most powerful party body, the Politburo standing committee, which is now ruled more by consensus. Vested interests have become so entrenched that reform is hard. Are the new men up to the job?

The list of changes needed is a long one. The party must reduce the power of the state-owned enterprises, which hog credit and stifle the growth of private enterprise. It also needs to reform a financial system that shovels the savings of individuals towards the inefficient state sector. Building a welfare state has become an economic priority, as well as a social one. Politically, there are a growing number of voices, even within the party, saying that broader reform is needed. There is little sign of political change, even though control may be more sophisticated (see page 44).

Local government is a mess. As well as opening up the economy, Mr Xi needs to start reforming the Chinese state at the ground level: introducing more competition into the appointment of government officials; reforming the courts to break the party's insistence that it stands above them and the

rule of law; and privatising land as a way to boost productivity, empower farmers and curb local officials who enrich themselves by grabbing rural land to sell for development.

Change will require bold leadership. The final standing committee line-up, after much horse-trading, has been reduced from nine to seven members. That might make consensus easier. Xi Jinping has also gained control of the key Central Military Commission, something Mr Hu had to wait two years for. This centralising of power, and the fact that at least five of the seven members are broadly from the same faction of the party (backed by Mr Jiang), suggest a unanimity that could aid reform if Mr Xi chooses to go down that road.

Three things sadly make change less likely. The first is the type of leader who rises to the top in China's opaque system. Officials achieve promotion not by being bold but by playing safe, and by cultivating high-level patrons. They still live in constant fear of China going the way of the Soviet Union. Second, many of those in power are "princelings", the offspring or sons-in-law of China's revolutionary families, who have become a self-enriching, hereditary class. Mr Xi is the son of one of Mao's closest comrades. He is married to one of China's most famous singers (see page 44) while his daughter attends Harvard under a pseudonym. Will a group of "red aristocrats" really be prepared to reform the system that has so enriched their families? The third is the continuing influence of party elders. The re-emergence of Mr Jiang as kingmaker has been especially clear this week.

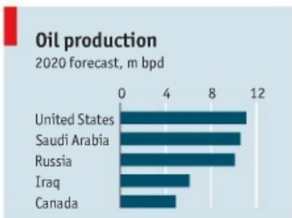
A new revolution

Yet an underlying force for change is coming from below. The Chinese people are cynical about politics and expect little but graft from their leaders; but they are also gradually becoming angrier. In his first speech Mr Xi admitted that the party faces "severe challenges" and said that corruption must be dealt with. With luck that is a sign that he will act against those vested interests, rather than just paying lip service to reform. Playing safe is not an option, given the scale of China's problems. The princeling must become a bold king. ■

Oil and gas

America's oil bonanza

A good thing—but it would be better if energy was priced correctly in the United States



THE shale-gas revolution in America has been as sudden and startling as a supertanker performing a handbrake turn. A country that once fretted about its dependence on Middle Eastern fossil fuels is now on the verge of self-sufficiency in natural gas. And the news keeps getting better. This week the International Energy Agency (IEA) predicted that the United States would become the world's largest oil producer by 2020, outstripping Saudi Arabia and Russia (see page 63).

Why has this happened? Price signals work. Oil has been costly for more than a decade. This has spurred prospectors to look harder for unconventional fuels: oil and gas that lie deep under the sea, buried in shale beds or stuck in Canada's vast oil sands (see page 62). They have developed whizzy technology to extract these hydrocarbons, with such success that North America now has a gas glut. Prices have plummeted, prompting shale-gas frackers to drill for pricier shale oil instead. According to the IEA, America could become self-sufficient in energy by 2035. Bolder analysts say sooner. Canada has immense potential, too. Besides the oil sands, a recent report suggests that the province of Alberta alone may have shale gas and oil reserves to rival America's.

The North American hydrocarbon bonanza offers big benefits, but also some pitfalls. The economic pluses are obvious: cheap gas yields cheap electricity, which boosts American industry, especially power-hungry sectors such as aluminium, steel and glass. Cheap gas also buoys petrochemicals firms, which use it to make useful stuff such as plastic. Also, America consumes some 19m barrels of oil a day. Imported oil costs $109 a barrel. Not having to pay Saudi Arabia for this is a boon.

The environmental scorecard is more mixed. Burning fossil fuels adds to greenhouse-gas emissions, which cook the planet. But the dash for gas has reduced American emissions, since gas is cleaner than coal. By contrast, in Europe, which does have a carbon-trading system but never developed shale gas, emissions have risen over the past three years. Europeans are shuttering nuclear-power plants and backsliding to filthy coal.

How to use a windfall wisely

It will be years before renewable energy is cheap and reliable enough to replace fossil fuels entirely. For now, hydrocarbons and the warming they bring with them are necessary evils. Rather than trying to distort their supply, the American government's job should be to let the oil and gas flow, where it is safe; but at the same time force those who use it to pay the full costs of that fuel—including those to the environment and the planet—and seek to spread the development of alternatives.

America has got the first part of that right, especially when it comes to encouraging innovation. Its landowners own the minerals below their turf, giving them a huge incentive to allow exploration (unlike Europe's). There are a few barmy rules, such as a ban on crude-oil exports, but it can still sell the refined version. Barack Obama should approve the proposed Keystone XL pipeline, which would carry Canadian oil to the Gulf of Mexico. Greens fear leakages, but overland pipes are far less risky than, say, shifting oil in trucks, and the pipe's owners would have to pay for any clean-up.

Where American energy policy is far less sensible is when it comes to the price reflecting the true cost. Tiny petrol taxes take no account of the damaging effects of pollution. This newspaper has long argued for a carbon tax to make dirty energy more expensive and thus curb demand. If that happened, some of the new oil might not be worth extracting: Canada's heavy oil, for instance, emits about 6% more carbon dioxide than normal oil, which in turn can be 30% dirtier than gas. The biggest bonanza from all this new energy would be if the users paid the real cost of consuming oil and gas. ■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Our endorsement

SIR – I have been an avid reader of your publication for 15 years and recommend it often. I was very disappointed, however, to read your endorsement of Barack Obama ("Which one?", November 3rd). On the one hand, I strangely find myself agreeing with the devil-we-know argument; both he and Mitt Romney are enigmatic manifestations of whatever a poor statesman is. On the other hand, we know enough to understand that the president has a distaste for commerce.

Never before have I felt as convincingly as I do now that the state sees the profits of my company and its employees as the spoils of exploitation that it must reclaim for the purpose of replenishing that which we have pillaged. In regulation after regulation, tax after tax, and mandate after mandate, commerce is guilty until proven innocent. So often, our attempts to press forward are countered by nothing less than an unworthy, timid ignorance that, unfortunately, is the law of the land. Progress will have to wait. I am upset that your endorsement overlooked the gravity of that consequence.

JOHN LARSON
President
Precision Instruments
Des Plaines, Illinois

SIR – I wonder whether you might have established some sort of record as the newspaper that most frequently tells its readers of its support for a smaller state while simultaneously endorsing candidates who espouse big government?

RICHARD THOBURN
London

SIR – Your tepid endorsement of Mr Obama was made worse by the advice you proffered after his re-election that he should "Now, hug a Republican" (November 10th). That is an awful lot to ask.

You made out that the president's lacklustre first term was down to an unwillingness to "reach across the aisle", a claim as false as most of the ads aired by Mr Romney. What about Grover Norquist's indentured congressmen? Or Mitch McConnell, who declared co-operation to be off the table before Mr Obama had even done anything? If the Republicans' leader in the Senate ever decides to hug the president, be sure to have a photographer ready: that picture should definitely make the front page.

JIM HANZEL
Winona, Minnesota

SIR – Lexington asserted that gerrymandering "does not fully account" for the Republicans' ability to retain a majority of 40-odd seats in the House of Representatives (November 10th). Yet the Democrats won around half a million more votes in House elections nationwide than Republicans. If that isn't gerrymandering, what is?

JACOB WOLKOWITZ
Minneapolis

SIR – *The Economist*'s position on the controversial remarks regarding rape and abortion by Todd Akin and Richard Mourdock, two Republican candidates for the Senate, was far too weak. The comments made by both these men were outrageous. Or to quote Karen Hughes, a former adviser to George W. Bush, in a column for *Politico*: "If another Republican man says anything about rape other than it is a horrific, violent crime, I want to personally cut out his tongue."

CLIVE MCCARTHY
San Francisco

SIR – Your endorsement of Mr Obama and his policies for a second term reminded me of Samuel Johnson's aphorism, that getting married a second time represents the triumph of hope over experience.

HAL CARROLL
Hell, Michigan

NATO exercises

SIR – Your observation that NATO's "Steadfast Jazz" military exercises are based on "defending Poland and the Baltic states against supposed Russian aggression" mistakes their purpose ("The shocking Mr Schockenhoff", November 10th). The Steadfast exercises train, test and certify the personnel of the NATO Response Force, a multinational, all-services grouping. So far, 17 exercises have been held in the series, with elements hosted in 14 different countries. The basis is always a fictional scenario involving a fictional opposing force from a fictional country. The goal is to make sure that NRF troops are ready to deal with any situation in any environment. Steadfast Jazz 2013 is not directed against any particular country, any more than its 17 predecessors were.

OANA LUNGESCU
NATO spokesperson
Brussels

Japan needs to open up

SIR – Your leader on corporate governance in Japan was right to identify the insularity of Japanese companies as a huge problem ("Olympian depths", November 3rd). I first moved to Japan in 1978. I have lived there on three different occasions and have a great affinity for the country and its people. But I'm saddened and alarmed by the continuing struggle to globalise at Japanese firms.

They are being left behind while the world is racing ahead. In 1995 the Fortune Global 500 had more firms from Japan on its list (141) than any other country, including America. That number has since dropped by half to 68 in 2012. Meanwhile, the number of American and European companies has basically held steady, while emerging market giants from the BRICs have replaced Japanese companies.

My research shows that this is mostly because Japanese firms have failed to identify, develop and promote people who aren't Japanese into senior leadership positions. So far there is little data to suggest this pattern of resistance will change anytime soon, increasing the likelihood that they will get left further behind in the globalisation race.

STEWART BLACK
Professor of global leadership
IMD
Lausanne, Switzerland

The bank that likes to say yes

SIR – It is indeed true that Bangladesh's remarkable progress in improving the lives of its poorest people is vulnerable to political interference ("The path through the fields", November 3rd). A clear case in point is the purge by Sheikh Hasina, the prime minister, of the leadership at Grameen, a bank that has done much to alleviate poverty through its lending programme. The government may even try to turn Grameen's 8.4m borrowers into a ballot bank for next year's election, by waiving their interest payments in exchange for votes. Sheikh Hasina must release her grip on this institution, which has lifted millions of women out of poverty in Bangladesh.

ALEX WILKS
Campaign director
Avaaz
Bristol

A storm over Sandy

SIR – The argument that rebuilding after a natural disaster is a form of stimulus ("Wild is the wind", November 3rd) reminded me of Frédéric Bastiat's 1850 parable of the broken window. If repairing destroyed property is a benefit to society, why don't people (especially glaziers) purposefully smash windows?

The dilemma is that there are hidden opportunity costs to public works: the money we will spend on rebuilding after Sandy might have been better spent on other goods and services, such as constructing defences against future storms. You can be sure that the cost of repairing buildings after Sandy's destruction will be borne by other bits of the economy. Although glaziers will be happy.

SIMON GARDENER
Atlanta ■

Letters are welcome and should be addressed to the Editor at
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Director, FP 2020 Task Team

Following the July 2012 London Summit on Family Planning, the Bill and Melinda Gates Foundation (BMGF), the UK Department for International Development (DFID), the United Nations Population Fund (UNFPA) and the US Agency for International Development (USAID) came together building on the partnership created through the Summit to further develop the Family Planning 2020 (FP2020) initiative which will support the implementation of the commitments made at the Summit and realize the Summit goal to enable an additional 120 million women to use voluntary family planning by 2020.

The FP2020 Task Team will work with existing partners and processes and will support the achievement of the UN Secretary General's Global Strategy for Women and Children's Health 'Every Woman Every Child'. FP2020 will be governed by a Reference Group which will be composed of a wide range of partners and will set strategic direction and drive progress towards meeting the Summit commitments and goal. The Director of the Task Team will report to the Reference Group and will oversee a team of staff, working closely with several Working Groups which will provide technical advice and support. The future Director and the Family Planning 2020 Task Team will be employed and hosted by the UN Foundation in New York.

FP2020 is therefore looking for a senior executive with a strong track record in global public Health to lead this Team, whose goal is to work with existing partners and processes to provide coordination, monitoring and support to Family Planning activities around the world to meet the Summit goal. The future Director should have a strong record in Family Planning in the context of sexual and reproductive health and rights, and be able to act as a thought leader in this area when required but also work effectively behind the scenes to drive global coordination and monitoring of these efforts across all the partner organizations.

For more information on this role and requirements please go to:
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More and more and not enough

BARCELONA

Europe's peripheral economies have already undergone a lot of restructuring. But without action by the rest of the euro zone, it risks being in vain

THE port of Barcelona, Spain's third-busiest, used to handle more imports than exports. This has now turned around, says Santiago Garcia-Milà, the port's deputy general manager; among many other things, ships are now for the first time taking cars off to China. The European Commission believes that this year exports of goods and services from Spain will be 22% greater, in real terms, than they were in 2009, as will exports from Portugal. Irish exports are expected to have grown by 15% over the same period, and if the rate is a little slower the growth matters even more; Irish exports are worth about 100% of GDP, whereas in Spain the share is about 30%.

Growth in exports, and with them strongly reduced current-account deficits, are one sign of change on Europe's periphery. Budget deficits have also been dropping. So have labour costs, increasing competitiveness. One measure of the scope of the efforts under way is the wave of industrial protest against them on November 14th, which included a general strike in both Spain and Portugal and smaller protests in Greece and Italy.

There remains much for these countries to do by way of "structural reform"—shake-ups of product and labour markets that will cause more pain and unrest. And little of the limited good news spreads as far as Greece, where exports are barely rising and which remains, in effect, insolvent. But the amount of both fiscal and economic progress in Spain, Ireland and Portugal, and to some extent Italy, is both underappreciated and heartening. The south is more than half way through the adjustment that is needed, says Julian Callow of Barclays, a bank, and still going in the right direction.

Even if such efforts are continued and strengthened, though, they cannot in themselves be enough. If the euro crisis is ever to be resolved, the divide that opened up in the first decade of the single currency between creditor countries in the northern core of the 17-strong euro zone and debtor nations in the south must be closed. That will require concerted action from the core countries of the north, as well.

There has been some helpful action at the level of the euro zone as a whole. Tensions in financial markets have eased since Mario Draghi, head of the European Central Bank (ECB), said in July he would do "whatever it takes" to save the euro. The ensuing commitment by the ECB to buy short-term sovereign bonds of beleaguered countries without limit (under strict conditions) is a treatment for the symptoms of the crisis rather than its causes. But the relief it has brought by reducing bond yields is still welcome. The effect was most obvious in Spain, which was on the brink of requiring a bail-out for its public finances on top of the one earlier provided to its banks. But yields dropped elsewhere, too—in Portugal ten-year-bond yields fell from 11.1% to 8.8%, in Italy from 6.5% to 4.9%. In part as a result, Ireland has been tapping financial markets for the first time in two years.

This improvement may owe much to Mr Draghi, but it also reflects real change in the south, where yawning budget deficits have been cut back. A crucial measure is the primary budget balance (ie, before interest), which needs to swing into surplus in order to prevent debt from spiralling out of control. The size of the necessary surplus depends on growth rates, interest rates and the stock of debt. Since 2009 primary deficits have narrowed a lot in southern countries (see chart 1), and Italy's has returned to surplus.

Current-account deficits are also improving. The room for improvement, admittedly, was vast. The deficits in Greece and Portugal peaked in 2008 at 18% of GDP and 12.6% of GDP, respectively. Spain's peaked at 10% the year before. Deficits throughout the periphery have shrunk notably since then (see chart 2). Ireland, where the deficit peaked at 5.7% of GDP in 2008, has been running a current-account surplus since 2010. Portugal and even Greece have been running surpluses in recent months, though this may not last. The European Commission's projections show both countries running a deficit in 2013, with Greece's still worryingly high at 6.3%. ▸▸

On the up... 1

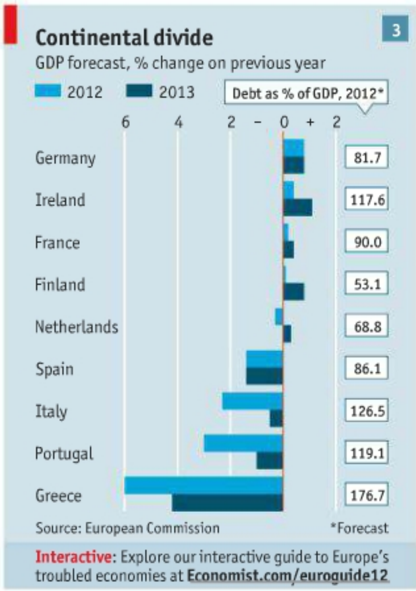
Primary budget balance, % of GDP

Source: IMF *Forecast

...and up 2

Current-account balance, % of GDP

Source: European Commission *Forecast



Italy's deficit, meanwhile, shrank from 3.5% in 2010 to 1.2% this year.

Indicators of underlying competitiveness like unit labour costs have also turned in the right direction in most of the countries in trouble, though Italy's are still rising. Ireland has done the best, with a 14% improvement since 2008. And there has been progress on the structural reforms needed to allow southern economies to cope with the rigours of the single currency in the longer term. How much progress is hard to say, because the reforms cover such a wide range of regulations affecting businesses and workers. Mr Draghi said on November 8th that the peripheral economies had moved far faster in this area in the past year than they had before. But as Mr Callow notes, progress on structural reforms lags behind the improvement on external adjustment.

The missing ingredient

All the progress, though, needs to be judged in the harsh light of the periphery's lack of growth. Although the improvement in the south's balance of payments is welcome in as much as its exports are finding markets, much of it is due to the fact that demand for imports has fallen in its recession-stricken economies. As far as GDP and unemployment are concerned, the economic divide between the periphery and the core is continuing to widen (see chart 3). Next year the European Commission expects the euro area to grow by just 0.1% (following a decline of 0.4% this year). But whereas GDP in Germany will rise by 0.8%, the same as this year, it will fall in Spain by 1.4%, and in Portugal by 1% (after a 3% fall in 2012). Italy's GDP will decline by 0.5%, after a 2.3% decline in 2012. The Greek collapse will continue for a sixth year, with output shrinking by 4.2%. The divergence will be just as marked for unemployment, predicted to be 5.6% in Germany compared with 26.6% in Spain.

This lack of growth is the heart of the problem: the south is being subjected to self-defeating austerity, which drives economies down, makes it harder to close deficits and raises debt. The bigger the debt burden—which exceeds 100% of GDP in Greece, Italy, Ireland and Portugal—the more important the gap between interest rates and growth becomes, and that gap widens when economies are shrinking. In such circumstances the growth in the stock of debt can accelerate even if deficits are shrinking. The main reason why the Greek debt burden is expected to get worse despite serious deficit reduction is that its economy has continued to nosedive.

Further structural reform could help provide the needed growth. One way to see the scope for improvement is in the World Bank's "ease of doing business" measurement, derived from factors such as the time it takes to start a business, register a property and enforce contracts. Figures released this October show that Greece, Portugal and Spain have all significantly narrowed the gap that divides them from the best European countries in which to do business by reforming things like construction permits and procedures for insolvency. But though the gap has been narrowed, it is still present. And in the case of Italy it has narrowed very little.

But the rest of the euro zone also has a role to play in delivering the growth that the south needs. The country with the most to offer is Germany. Although its surplus with the euro area has fallen a lot, it still amounted to 2.3% of GDP in 2011. Germany resists structural reforms in its underdeveloped services sector that would generate more domestic demand in the longer term. And its citizens remain hostile to the idea of inflating away some part of their competitiveness in order to make things easier on their cousins in the south.

A narrowing fiscal and economic divide between north and south is a necessary condition for ending the euro crisis, but it is not a sufficient one. The crisis has led to a deep gulf between financial conditions in the north and south. In the north, businesses and households can borrow at cheap rates. In the south, they have to pay much more, and often banks just don't want to lend at all. Despite emergency measures by the ECB—including the provision of €1 trillion ($1.3 trillion) three-year central-bank funding to European banks last winter, most of which went to the periphery—this divide persists.

This reflects the third dimension of the euro crisis: that it involves not just collapsing public finances and huge trade imbalances but fragile financial systems, which are susceptible to investor panics. Weak government finances left banks with lots of dodgy government debt; in Ireland and Spain, which experienced epic housing boom-and-busts, self-inflicted wounds by the banks weakened the governments. The pernicious link between banks and governments stymies progress.

Putting this right requires a return of confidence on the part of private investors outside the south, which would ease financing pressures. But although yields have fallen, private investors are still leery of investing in the south. Its banks remain heavily reliant on ECB funding. The "Target2" imbalances between central banks—liabilities chalked up in the south by, for example, the Bank of Spain and claims accumulated in the north, especially by the German Bundesbank—have recently fallen a little but remain extraordinarily high, which indicates the extent to which central banks have been financing capital flight from the south.

Say not the struggle naught availeth

Breaking the vicious circle between weak banks and weak sovereigns requires a big leap forward in economic integration: a euro-area banking union (see page 68). Although European leaders recognised the necessity of this reform over the summer, they have since been backtracking on making it a swift and meaningful reality. In particular, hopes of introducing euro-wide deposit insurance are dwindling.

That is characteristic of the way the euro crisis has been mishandled. Whenever the ECB has countered market fears, its reaction has taken the pressure off European politicians and they have dragged their feet. Spain is a prime example. Mariano Rajoy continues to hesitate over seeking a bail-out which could trigger the ECB's bond-buying policy, even though that may mean that he eventually has to ask for one from a position of weakness rather than strength. Despite all the adjustments, the euro area remains vulnerable to economic setbacks and political upsets, especially in the south (and above all in Greece). And the progress has been bought at a price. How much more will electorates be prepared to suffer without seeing more convincing and rewarding results? ■

Also in this section

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Californian politics

Brownian motion

LOS ANGELES

The passage of a tax measure and a political realignment have left California's unpredictable governor in a strong position

ON NOVEMBER 6th Americans voted for the presidential and congressional status quo. But Californians decided to set their state on what may be a new course. Proposition 30 became the first tax-raising measure to win the support of a majority of voters since 2004, averting planned deep education cuts and bringing California closer to fiscal health. The state's Democrats, already dominant, were returned to both houses of the legislature with supermajorities of more than two-thirds that grant them sweeping new powers, including the ability to raise taxes unilaterally. The scene was set, feared some, for a particularly gruesome episode of what the *Wall Street Journal* called "the Liberals Gone Wild video that is Sacramento".

Unions certainly wasted no time urging their newly empowered Democratic allies to begin reversing some of the deep cuts of recent years. But the state's leaders tried to dampen their expectations. A victorious Governor Jerry Brown, his voice gruffer, his pate sparer and his metaphors more florid than during his first stint in office over 30 years ago, called for California to adopt "the prudence of Joseph" in the coming years. His legislative colleagues warned that they were not about to jack taxes up further.

That is wise. Prop 30, or something like it, may have been necessary to stanch California's budgetary bleeding. But it leaves the state with the highest top income- and sales-tax rates in the country. Most of its revenues will come from high earners, which will do little to ease California's business-unfriendly reputation.

On November 14th the independent Legislative Analyst's Office declared that the "budget situation has improved sharply." But the state's fiscal problems are hardly over. Borrowing costs are high, and the credit rating dreadful. An over-reliance on income- and capital-gains taxes on the wealthy makes revenues highly volatile: when the Dow sinks, so do revenues

Still, the success of Prop 30, which had looked to be in trouble in polls, leaves Mr Brown looking strong. Asked about his priorities for the two remaining years of his first term, he reels off a list that includes infrastructure schemes such as high-speed rail and water-diversion projects, as well as education and green-energy plans.

He acknowledges that work remains to be done on the long-term liabilities of the state pension system, but seems less keen on tax reform: economists would like to see the state's tax base broadened and sales tax extended to services. "What is the justification for going through all that turbulence?" Mr Brown asks. (The last attempt to reshape the tax code came from a commission appointed by Arnold Schwarzenegger, Mr Brown's predecessor. It was completely ignored.)

Then there is Proposition 13. A populist measure passed in 1978, during Mr Brown's first governorship but against his wishes, the initiative slashed property taxes, introduced the two-thirds legislative requirement for tax rises and reshaped the relationship between state and local government. Nationally, it began a tax revolt that helped lift Ronald Reagan to the presidency. California's liberals have long wanted to reform (or remove) it, but politicians have considered it untouchable.

That may now change. A full-throated assault on Prop 13, whose basic precepts remain popular, is unlikely. But two provisions may come under attack. First, the two-thirds voter approval requirement for the passage of "parcel taxes"—essentially measures designed to work around the constraints of Prop 13 at local level, including school districts. Some, including Darrell Steinberg, president *pro tempore* of the state Senate, want to reduce that to 55%. Second is Prop 13's failure to distinguish between residential and commercial properties. At the moment all property values (and hence tax bills) are reassessed only when ownership is transferred. Many favour a "split roll": annual reassessment of commercial property value, which in a rising market would mean higher revenues.

Many businesses supported Prop 30, at least in public. Yet even minor tweaks to the totemic Prop 13 would spark anger. If the Democrats go for the split roll, says Bill Whalen, a research fellow at the Hoover Institution, "the business community will have to fight." Jon Coupal, president of the Howard Jarvis Taxpayers Association, a lobby group named after the man behind Prop 13, says the organisation will exert ▸▸

"whatever political pressure we can" to head off threats to Jarvis's creation.

For his part, Mr Brown appears to want to get things done rather than to get into scraps. But much will depend on how restive the victorious Democratic lawmakers prove to be. The tightness of the elections of some, and the brevity of their terms, should deter their more radical ambitions. But precisely because the supermajority is unlikely to hold for longer than two years, interest groups will want to exploit an opportunity they may not soon see repeated.

If it does prove fractious, the big Democratic tent could, paradoxically, provide an opening for the few Republicans still limping around Sacramento. Some items on Mr Brown's to-do list, including pension reform and a softening of environmental rules, will alienate some of his party allies. Republicans could stem their slide into oblivion by working with the governor on such issues. Whether they choose to is another question; as the party has shrunk it has hardened, and after its latest reversals it may turn out to have calcified.

Mr Brown has positioned himself well to take advantage of the new political dispensation, says Raphael Sonenshein of the Pat Brown Institute of Political Affairs (named after Mr Brown's father, another former governor). The political capital he earned with the passage of Prop 30 means that Democrats, Republicans, business and unions alike must, in practice, go through him if they want to get anything done. And if his unpredictability, what Mr Sonenshein calls his "Brownian motion", once made it hard for him to form alliances, it now grants him a useful flexibility.

For many Americans, California has become a byword for debt, dysfunction and decline. Mr Brown says he will make it his business to refute such notions. Few governors of California leave office unscathed. Mr Brown has not even said whether he will run for a second term. But if he can find a way to exploit this moment this most protean of politicians may find a way to leave the legacy he craves. ■

The Petraeus affair

The man and his myth

The questionable legacy of General David Petraeus

DESPITE a torrent of lurid detail emerging from the FBI investigation that led to the fall of the director of the Central Intelligence Agency, David Petraeus, and attempts to attach significance to the delay in informing the president of his chief spy's plight, the political consequences are likely to disappoint Barack Obama's enemies.

Conspiracy theorists see a connection between the resignation of the nation's most famous soldier on November 9th over an extramarital affair with his biographer, Paula Broadwell, and congressional investigations that were ongoing this week into the deaths in Benghazi last September of Ambassador Christopher Stevens and three other Americans. But while the CIA over-relied on the security supposedly provided by Libyan militias, there is no evidence that rescue attempts were deliberately delayed by the agency's leadership or the White House.

The shock-wave caused by the departure of General Petraeus might indeed have been an unwelcome distraction from an election campaign that was going Mr Obama's way, but he was above all a hero to Republicans. He had even been seen as a possible vice-presidential pick before his appointment to the CIA job 17 months ago.

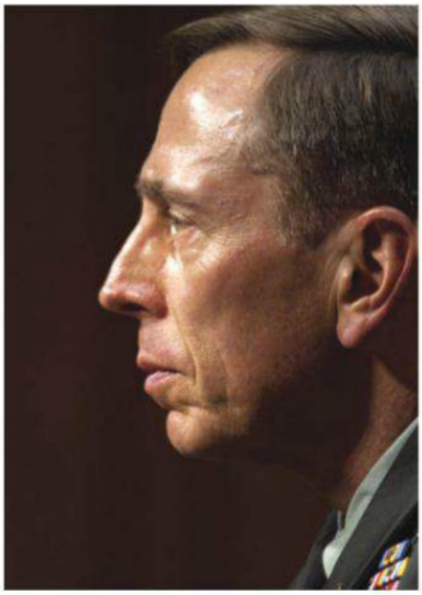
Of more abiding interest is what sort of legacy an extraordinary career has left. The general's status as the epitome of the modern soldier-statesman-scholar was rooted in both real achievement and a myth of his own and others' creation. Back home after two tours in Iraq, he used the time to digest the lessons he had learned to rewrite the army's field manual on counterinsurgency (COIN). At the heart of what became known as "population-centric COIN" was the notion that the operational priority should be providing security for ordinary people and thus creating the conditions for a government under attack by an insurgency to earn legitimacy though the provision of goods and services.

By late 2006, faced with what looked like a descent into bloody civil war, most senior American officers were ready to give up on Iraq. However George W. Bush, desperate to try to find a less appalling denouement to the war, saw General Petraeus, supported by a controversial "surge" in troop numbers, as a possible lifeline for his reputation. How much of the (relative) success that followed was due to General Petraeus and how much the so-called "Anbar Awakening"—the rejection by Sunni tribal leaders of al-Qaeda's ethnic slaughter that had begun shortly before the general's return in January 2007—is still argued over. General Petraeus may have been lucky, but he worked with the grain of events to bend the history of the war around a narrative of narrowly averted disaster that was more or less true.

In June 2010, when Stanley McChrystal, his dedicated protégé, resigned as commander in Afghanistan after the reporting of remarks by his staff critical of the new administration, General Petraeus was sent for by Mr Obama to repeat his magic in Kabul. A time-limited troop surge was under way, but he knew official patience was running out and that the chances of applying a successful COIN strategy in a country as divided and poor as Afghanistan were slim. Even so, the speed with which he abandoned it in favour of a much more "kinetic" approach aimed at getting a quick improvement in security by killing as many Taliban as possible was breathtaking.

By the time General Petraeus handed over to his successor, General John Allen, 13 months later, a deadline for the withdrawal of foreign troops at the end of 2014 had been set. General Allen was bizarrely drawn into the Petraeus scandal on November 13th when the Pentagon revealed that he had exchanged thousands of e-mails over a four-year period with Jill Kelley. Ms Kelley, a Tampa-based socialite who knew both men, triggered the FBI inquiry into the CIA director last May after receiving threatening e-mails from an apparently jealous Ms Broadwell. General Allen's confirmation hearing as the new supreme commander in Europe has been put on hold because of the "inappropriate" nature of some of the e-mails.

COIN required more time and money than war-weary, economically stressed voters would stomach. As Mr Obama reiterated during his re-election campaign, nation-building now needs to take place at home. Boots on the ground are out again; special forces and drones, used to seek out ▸▸



From war hero to zero

and kill America's enemies, are back in. After becoming director of the CIA, which has become the lead agency in fighting the high-tech, intelligence-led campaign against al-Qaeda and its offshoots, General Petraeus had no compunction in helping strangle his own COIN baby when it had outlived its usefulness.

As its director, General Petraeus was an enthusiastic advocate for the increasingly paramilitary CIA that has evolved over the past decade. He recently asked for a further ten aircraft to be added to the agency's fleet of 40 or so Predator/Reaper drones. But concerns have grown, even within the administration, over the perceived lack of accountability underpinning the CIA's remote killing of terrorist suspects. Whoever succeeds General Petraeus, possibly the current acting director, Michael Morell, or possibly John Brennan, Mr Obama's counterterrorism adviser, may want to do things differently, perhaps handing over the main responsibility for drone attacks to the Pentagon's Joint Special Operations Command and re-emphasising the agency's traditional intelligence-gathering role.

For all his great public service, his intellectual dazzle and his uncanny ability to win over both hard-bitten reporters and sceptical lawmakers, General Petraeus may not actually be much missed. ■

The cabinet

Room at the top

WASHINGTON, DC

Barack Obama is changing his most senior officials

IT IS typical of the diplomacy displayed by Hillary Clinton over her four years as secretary of state that she contrived to be as far from Washington as possible—in Perth, Australia—as speculation about her successor reached full frenzy this week. Would Barack Obama pick Susan Rice, currently America's ambassador to the United Nations, in spite of her embarrassing misrepresentation of the recent murder of American diplomats in Libya? Or might he opt for John Kerry, the chairman of the foreign-relations committee in the Senate, in spite of the risk that the Democrats might lose the subsequent by-election for his seat? And how might that decision affect the host of other cabinet jobs thought to be up for grabs?

It is a tiring business running a big chunk of the federal government. Mrs Clinton has racked up 918,375 miles on the job visiting 112 countries. Tim Geithner, the treasury secretary, has had to cope with a state of near-perpetual crisis since he took office four years ago. Leon Panetta, the secretary of defence, is running an organisation of some 2m people and overseeing the war in Afghanistan at the age of 74. The Republican leadership of the House of Representatives is pursuing a legal battle with Eric Holder, the attorney general, who has ignored some of their subpoenas. All four have signalled, with varying degrees of clarity, that they are ready to move on—leaving vacancies in the four grandest cabinet jobs at the very least.

What's our next move?

Mr Obama's cabinet has had relatively little turnover so far. Only three full members have resigned: Robert Gates, his original defence secretary, who was himself a holdover from the administration of George W. Bush, and two successive commerce secretaries, Gary Locke and John Bryson—the first to become ambassador to China and the second after causing a string of traffic accidents. Some seem likely to stay on either because they visibly enjoy their jobs, like Arne Duncan, the secretary of education, or because they are in the midst of a vital task, like Kathleen Sebelius, the secretary of health and human services, who is implementing Mr Obama's health-care reforms. Others, including Mr Geithner, are thought to have stayed until now only to avoid the disruption to their departments and the bickering with the Senate over a replacement that a resignation would probably have entailed.

The bickering will be especially vociferous if, as expected, Mr Obama nominates Jack Lew, his chief of staff, as the next secretary of the Treasury. Mr Lew managed to rub senior Republicans the wrong way during failed negotiations between the White House and Congress on a "grand bargain" to cut the deficit last year. Moreover, many had been hoping that Mr Obama would send a signal that he is serious about cutting spending and nurturing business by appointing either a successful executive (perhaps Larry Fink, the boss of Blackrock, the world's biggest asset-management firm) or Erskine Bowles, a former investment banker and White House chief of staff who served as co-head of Mr Obama's deficit-reduction commission in 2010. The president, however, is said to be in a fighting mood after his re-election, and generally prefers to promote loyal lieutenants of long standing, like Mr Lew.

The selection of Ms Rice as secretary of state would also spark a row. In the immediate aftermath of the Libyan attack, she was the main voice in the administration describing it, mistakenly, as an act of mob violence, rather than terrorism. Republicans have railed against this version of events as inexcusable incompetence if not wilful deceit. But after a poor showing in the elections with women and minorities, they may not want to pillory an otherwise well-qualified black woman. Mr Obama this week defiantly declared their criticism of Ms Rice "outrageous".

The likeliest alternative to Ms Rice is Mr Kerry, who has also been spoken of as a possible secretary of defence. As a senator himself, Mr Kerry would easily win approval from the Senate for either job. But Republicans would be voting for him in part because they would have a strong candidate to fill his seat: Scott Brown, the recently defeated but nonetheless popular junior senator from Massachusetts. Another candidate to succeed Mr Panetta is Michèle Flournoy, who as undersecretary for policy was the most senior woman in the Pentagon hierarchy and would be the first female secretary of defence.

Aspiring attorneys-general are thought to include Deval Patrick, the governor of Massachusetts and a former official at the Justice Department, and Janet Napolitano, who is currently secretary of homeland security but previously served as both attorney-general and governor of Arizona. And once Mr Obama has all the grander jobs squared away, he will still need to find a third secretary of commerce. ■

Tax reform

Opening bids

WASHINGTON, DC

Barack Obama and Republicans grope towards common ground on taxes

THE election dust had barely settled when Barack Obama and his Republican adversaries returned to their traditional rhetoric over taxes. "Raising tax rates is unacceptable," John Boehner, the Speaker of the House of Representatives, declared on November 8th. The next day Mr Obama said "I am not going to ask students and seniors and middle-class families to pay down the entire deficit while people like me, making over $250,000, aren't asked to pay a dime more in taxes."

Optimists, however, took note of what the men did not say: Mr Boehner did not rule out raising tax revenues. Mr Obama did not explicitly insist that the two top income tax rates, now 33% and 35%, return to 35% and 39.6%, as they are scheduled to do when George W. Bush's tax cuts expire at the end of this year.

This has aroused hopes that the two men can find common ground on tax reform that leaves marginal tax rates where they are while raising new revenue by curbing credits, deductions and exemptions (collectively called tax expenditures), which distort economic activity. Numerous such proposals have been aired in recent years, some of which Republicans hated because they raised new revenue; others Democrats rejected because they gave a windfall to the wealthy.

Ways and means

to come

Proposal	Revenue raised 2013-22 $bn	% of GDP
Reinstate 35% and 39.6% upper-income taxpayer rates	442	0.2
Tax dividends & capital gains as ordinary income for upper-income taxpayers*	242	0.1
Reinstate limitation on itemised deductions/phase out personal exemption for upper-income taxpayers*	165	0.1
Limit deductions to 28% of income for upper-income taxpayers*	584	0.3
Raise estate tax to 45% from 35%, reduce exemption to $3.5m from $10m*	119	0.1
Tax carried (profits) interest as ordinary income*	13	0
Remove tax break for corporate jets	2	0
Repeal all itemised deductions	2,200	1.1
Cap itemised deductions at $25,000	1,177	0.6
Cap itemised deductions at $50,000	749	0.4
Cap itemised deduction tax savings at 2% of income	2,000	1.0
10-year budget deficit†	**9,974**	**4.9**

Sources: US Treasury; Tax Policy Centre; Martin Feldstein; Congressional Budget Office

*Revenue based on increased tax rates
†If current policies continue

One way this could be done is to target deductions that primarily benefit the rich. During the election campaign, Mitt Romney proposed paying for big marginal rate cuts by setting a cap on total deductions. The Tax Policy Centre, a think-tank, reckons a cap of $50,000 would raise $749 billion over ten years, comparable to the $800 billion that Mr Boehner entertained during failed negotiations with Mr Obama in 2011. Importantly, this fix would make the tax system much more progressive: 80% of the additional money would come from the top 1% of earners. This has helped draw interest from some Democrats.

A slightly different proposal by Martin Feldstein, a prominent Republican economist, and Maya MacGuineas of the Committee for a Responsible Federal Budget, a think-tank, would cap the tax benefit of itemised deductions at 2% of income for all households. Mr Feldstein reckons that would raise more than $2 trillion over ten years, although almost all families would pay more tax, not just the rich.

As it happens, Mr Obama has already proposed curbing tax breaks for the wealthy (see table). His budget would restore the limits on their exemptions and deductions that Mr Bush's tax cuts eliminated. A separate proposal would limit the tax benefit of deductions for mortgage interest, charitable contributions, municipal bond interest, employer-provided health care, and individual retirement plans to 28%, even for taxpayers paying a 35% or 39.6% marginal rate.

Despite their superficial appeal, such proposals face daunting obstacles. Foremost is that they may not raise enough revenue to satisfy Mr Obama. In the run-up to formal negotiations due to begin on November 16th, Mr Obama signalled he would begin by asking for $1.6 trillion in revenue over the coming decade, as his latest budget does. At a press conference on November 14th, he said "it's very difficult to see how you make up" the revenue lost from failing to restore the higher rates just by closing deductions: "The math tends not to work." But, he added, "I'm not going to just slam the door" on alternatives that accomplish what he wants.

The second obstacle is the calendar. Politicians are racing against a year-end deadline when Mr Bush's tax cuts and other stimulus measures expire and automatic spending cuts are triggered. The collective fiscal tightening, if sustained, could push the economy into recession. Even if the two sides agreed that tax reform would be the main vehicle for raising more revenue, the task would be too complex to accomplish by year-end. A smaller deal would be needed to avert the cliff, leaving bigger tax and entitlement changes for next year. The challenge then would be to bind the hands of both parties to consummating a big deal next year.

For all the appeal of curbing loopholes, each has vocal and influential defenders. When the Obama administration first proposed its 28% cap on tax expenditures, "we got killed," Peter Orszag, Mr Obama's first budget director, recalls, in particular by charities and non-profit groups. For Mr Obama and Mr Boehner, finding agreement with each other may very well prove to be the easy part. ■

Puerto Rico

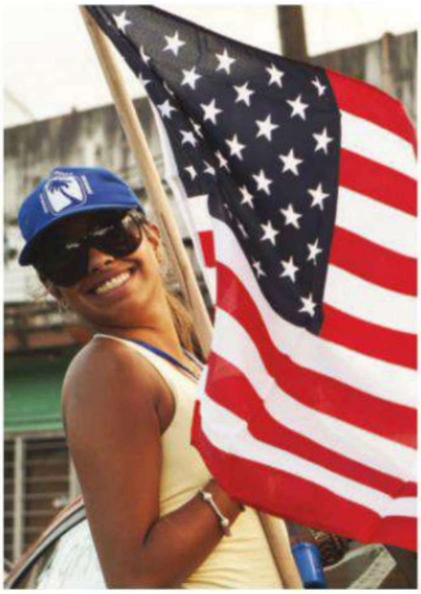
The 51st state?

NEW YORK

America may not want what its Caribbean outpost now does

VOTERS may have voted for more of the same in America on election day, but in Puerto Rico they opted for decisive change. In a two-stage plebiscite—the island's fourth referendum regarding its relationship with the United States—54% of the electorate voted to change Puerto Rico's current status as a self-governing "commonwealth", and 61% wanted the new form of government to be full American statehood. It was the first time a majority of *boricuas*, as the islanders are known, has voted to become the 51st state. In both the last two plebiscites, held in 1993 and 1998, only 47% chose that option.

The United States gained control of Puerto Rico in 1898, following the Spanish-American War. Puerto Rico set up its own government in 1952, and its residents do not pay federal income taxes to Washington on their local earnings. Nonetheless, it ▸▸



Longing to be American

is still effectively a colony: *boricuas* are subject to American law even though they cannot vote for president or Congress.

Puerto Ricans broadly agree on their preferred status: in a 1967 referendum, 60% voted for a commonwealth they were told would be gradually enhanced. In this scheme, they would keep their American citizenship, currency, defence and tax exemptions, But they would also receive long-sought-after improvements, possibly including a "compact" making their relationship with the United States permanent. They might also gain the right to control immigration, sign treaties, act independently in international groups and choose which federal laws (such as the minimum wage) would apply to them.

Unfortunately, this proposal is legally flawed. According to Christina Duffy Ponsa of Columbia Law School the only permanent way of belonging to the United States is through statehood. Any other status approved by one Congress could be revoked later. Similarly, Congress could exempt Puerto Rico from any given law, but could not let the island exclude itself from federal legislation at will. A presidential task force has concluded that the only permissible status options are statehood, free association, continuation of the current commonwealth status or independence.

As a result, when the ruling pro-statehood party won a legislative vote last year to hold a new referendum, it did not put "enhanced commonwealth" on the ballot. Residents were first asked whether to continue with the current arrangement, and then what other form of government they would prefer: statehood, independence or "sovereign free association", a voluntary, reversible collaboration with the United States that has been adopted by some Pacific island groups. Supporters of the status quo could choose a second-best option, but many left the second question blank.

Support for statehood has increased over the years, as ties between the island and the mainland grow closer. There are now more *boricuas* in the continental United States than in Puerto Rico itself, and American film, television and sports have gained popularity. Moreover, because of the Earned Income Tax Credit, a cash-transfer scheme for the working poor, many Puerto Ricans would gain more than they lose by becoming subject to federal income tax. But even among the rich and among Puerto Ricans without close links to the rest of the United States, the framing of the question ensured that statehood would prevail among the options for change. Both independence and sovereign free association would have put the islanders' American citizenship at risk.

The vote will not have immediate consequences. Congress would have to pass a law admitting Puerto Rico for it to become a state. With a fiscal squeeze looming at the start of 2013 lawmakers will have their hands full in the coming months. And the island's government is unlikely to push the issue aggressively following the election as governor of Alejandro García Padilla, who supports a continued commonwealth.

Moreover, the Republican-controlled House of Representatives has little incentive to address the topic. According to exit polls, 83% of *boricuas* on the mainland voted for Barack Obama. Statehood would add two Senate seats and a House delegation of five, the same size as Oregon's and probably as reliably Democratic.

Unless the island holds another vote that yields a different result, however, Puerto Rico has now officially requested statehood. If Democrats retake the House in 2014, they would be well-advised to try to add a 51st star to the flag. ■

Lincoln, the movie

How to be president

Hollywood might have a thing or two to teach Barack Obama

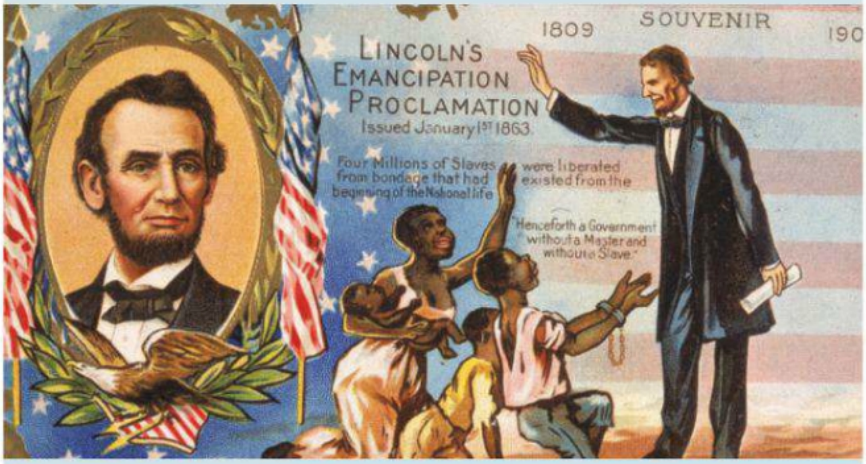
WITH the possible exception of Ronald Reagan, there is no more revered figure in American politics than Abraham Lincoln. In announcing his first campaign for the presidency, Barack Obama did everything but don a stovepipe hat to evoke the Great Emancipator. The comparisons came easily enough, as the gangly lawyer from Illinois with little political experience declared his intention to unite the country and overcome "the smallness of our politics".

But the better angels of our nature, those stubborn brutes, do not always respond to eloquent speeches. Sometimes the mundane and messy bits of politics cannot be transcended and instead must be mastered. If Mr Obama missed this lesson during his first term in office, he can sit through it again in Steven Spielberg's new movie "Lincoln", which opened on November 9th in America.

The film focuses on the last four months of Lincoln's life, during which he is faced with a complex set of challenges. The civil war is coming to an end, perhaps too soon for the president, who is played brilliantly by Daniel Day-Lewis. Lincoln implores the House of Representatives to speed through a constitutional amendment banning slavery, lest a defeated South revert to its old ways. But the legislation is doomed unless he can hold together an unwieldy coalition of his own Republicans, and win over a recalcitrant group of Democrats.

The means by which Lincoln pulls off this feat are not pretty. To square his own party, the president asks those calling for full racial equality to moderate their views. He then picks off his Democrats with a combination of cajolery, patronage and threats, dispensed by an amusing team of political fixers. The grinding work of the legislative process makes for a surprisingly tense drama.

Through it all, Mr Spielberg's Lincoln is fully engaged, with Mr Day-Lewis conveying the weariness of a man locked in battle with half the nation. The juxtaposition with Mr Obama is obvious. Criticised for his aloofness, the current president has often seemed removed from the political process—he has done little to nurture relationships with Republicans, while allowing others to craft his legislation. His presidency, as a result, has hardly been Lincolnesque. The comparison is in many ways unfair. But it was Mr Obama who first made it.



The art of the barely possible

Lexington | Taking the fight outside

Can presidential appeals to the American public break Washington gridlock?

SURPRISINGLY often, an American president can act only by appealing to the self-interest of others. Sharing power with a Congress whose members he does not recruit or dismiss, and perched atop a political party that he does not control, America's president is as much bargainer-in-chief as chief executive. True, the president enjoys vast formal powers, including rights of patronage and a legislative veto. When Congress is in the opposition's hands, the president can take arguments to the public and expect a hearing. Yet the presidential bully pulpit has its limits. It is a perch from which to cajole, more than a place for issuing orders. As Harry Truman ruefully described the job: "I sit here all day trying to persuade people to do the things they ought to have sense enough to do without my persuading them."

President Barack Obama—only the second Democrat to win re-election to the White House since Truman—seems to have come to a similar view of his role. A big bet underpinning his second term involves persuading (some) Republicans that their self-interest lies in helping him govern, after years of obstruction.

The president has cited areas in which bargains may be possible, though "messy". One involves what he calls a balanced deficit-reduction deal, involving spending cuts but heavier taxation of the wealthy. Another involves infrastructure investments. After Mitt Romney's dire showing with Hispanic voters, Mr Obama also argues that Republicans have a "deep interest" in immigration reform.

For months Obama advisers have argued that his big first-term blunder was trying to reason with congressional Republicans behind closed doors. Democrats in Congress suggest that a second-term goal should be to pick fights that split moderate Republicans from hardliners. To that end, he will head outside Washington, making his case to voters, pressure groups and business leaders until public opinion makes opponents see sense.

The rush for the bully pulpit began on election night, as Mr Obama told supporters that the work of citizenship does not end with voting. Three days later, Mr Obama stood in the White House—a campaign-worthy backdrop of multi-ethnic, multi-generational voters behind him—and declared that most Americans wanted Congress to agree a deal and avert a year-end budget crisis. Waving the pen with which he would sign that deal, Mr Obama insisted that voters had said "loud and clear" that they would not tolerate political dysfunction. Aides briefed that Mr Obama's formidable campaign machine from 2012 is not being dismantled, but will be left to hum and whirr in case his grassroots need summoning. Union leaders who met the president on November 13th emerged vowing to remain "mobilised".

Bully-pulpitry can work. Televised appeals to the nation helped Ronald Reagan prod a Democratic-controlled Congress into agreeing historic tax cuts. As he urged voters to hound members of Congress with telegrams and phone calls, Reagan reputedly told aides: "When you can't make them see the light, make them feel the heat." More than a decade on, public opinion helped Bill Clinton balance the budget with Republican help: conservatives were on the back foot after Mr Clinton convinced voters that congressional Republicans had overreached by shutting down the federal government in an earlier stand-off.

Yet failures abound too. After Mr Clinton's presidency was soured by scandals and sidetracked by a failed health-care reform, he was mocked for taking to the road to pitch footling policies about school uniforms and teen curfews. In contrast George W. Bush began his second term with an over-ambitious campaign to sell partial Social Security privatisation to the country.

A shrewd scholar of presidential power, Richard Neustadt, spent years pondering the conditions that a president must fulfil to mount the bully pulpit and prosper. It is a long list. The policy at stake must merit his personal intervention. Members of Congress must believe that the president has correctly estimated how his own supporters view the policy, and how their supporters will view them if they do what he wants. Finally, there is what might be termed the Machiavelli test: do those around the president believe he has the political skill and ruthlessness to reward or punish them? Fail to meet any of those conditions and a disaster looms: public defiance of a president's wishes.

Theodore Roosevelt knew how to do it

Judged by those stern rules, Mr Obama's path to success is narrow. He is right that most Americans are sick of Washington squabbling. But that is not enough. It is easy for voters to enthuse about bipartisan compromise. It is harder to agree such questions as how large government should be and how to pay for it. On many fronts, the country is split down the middle.

It is not very relevant if Mr Obama's half of the country cheers him on (indeed it may stiffen Republican spines). Public appeals serve Mr Obama if they make Republicans fear losing independent and moderate voters in sufficient numbers to put their seats at risk, starting with 2014's mid-term elections. Crudely, the game is to find the rare issues that enjoy majority backing in a country split 50-50. Only then will Republican self-interest kick in.

Mr Obama thinks that making the rich shoulder more of a burden is just such an issue. He may be right: certainly some Republican bigwigs are edging towards accepting new tax revenues, as long as tax rates do not rise. Immigration may be another issue ready to outgrow existing partisan boundaries.

That leaves the Machiavelli test. In his first term Mr Obama was cool with congressional allies and chilly with foes. That will have to change. If he takes big fights to the country, he will have to scrap in Washington too. By instinct, he might prefer to stay aloof. That, though, would not be in his self-interest. ■

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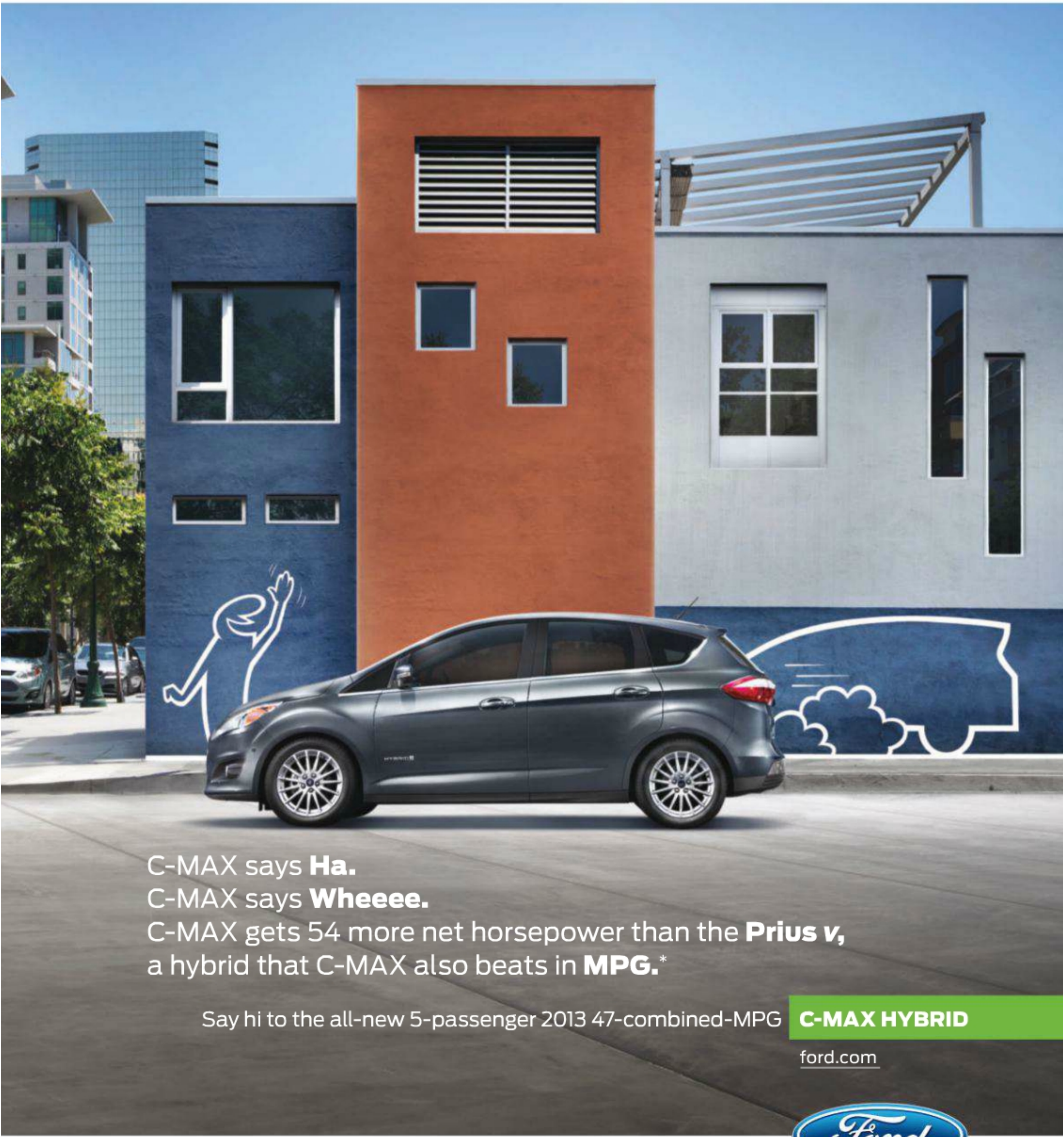

*EPA-estimated 47 city/47 hwy/47 combined mpg. Actual mileage will vary.

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Oil in Brazil

The perils of Petrobras

SÃO PAULO

How Graça Foster plans to get Brazil's oil giant back on track

BRAZIL'S discovery of oodles of offshore oil in 2007 felt like a transformative moment. For Petrobras, the state-controlled oil company, it raised the prospect of pumping 5m barrels a day by 2020, up from around 2m—meaning a windfall for the government and juicy returns for minority investors. Under Graça Foster (pictured), Petrobras's boss since February, the find may yet prove a boon to both. But they and she face a white-knuckle ride first.

Recent history is less than encouraging. Investors who bought in during Petrobras's share issue in 2010 have lost more than a quarter of their money at current prices. In August the firm posted its first quarterly loss in 13 years; the most recent quarterly results were limp. Meanwhile Colombia's Ecopetrol has knocked the company into second place in South America by market capitalisation.

What went wrong? Back in 2007 Petrobras's main worry seemed to be finding a way to pump the new oil, known as *pré-sal* ("beneath the salt"), which is buried under rock and salt in ultra-deep waters. But its engineers quickly cracked that problem: Petrobras produced 71,000 barrels a day of *pré-sal* last year. The world's biggest corporate-investment programme is taking the oil from the sea bed to market. Instead of know-how, the glitches have included poor management and ballooning costs.

The main difficulty, however, has been political meddling. Since 2006, the government has capped petrol prices to combat inflation. To meet rising demand, Petrobras has been obliged to top up what it produces with imports, which it must then sell at a loss. Legal requirements to hire and buy parts locally—to support Brazilian jobs and industry—have played havoc with budgets and schedules.

The problem is a decade old. By Latin American standards, Petrobras is a model state oil company; nevertheless Brazil's government has used it as an all-purpose policy tool. As well as keeping prices low, and helping the broader economy, it has been told to build refineries in the poor north-east to promote regional development. Rising resource nationalism meant that a previously liberal licensing regime was tweaked to make the firm the only principal operator allowed in *pré-sal* fields. That left other outfits frustrated and Petrobras overstretched. Ms Foster will need sharp elbows if she is to turn around Brazil's biggest company—which (with its suppliers) contributes around 10% of GDP, and on which the country's industrial development largely depends.

Ms Foster is a career engineer who worked her way up through Petrobras; a famously demanding manager; and a big change from her predecessor, Sergio Gabrielli, who was a smooth-talking politician first and an oilman second. She is diplomatic about her predecessor, but has replaced some of his acolytes and is reviewing many of the deals signed during his tenure. Her five-year corporate plan, launched in June, cut his production target for 2020 by 11%. In future, she promised, the firm would be "more realistic".

She describes her approach as "a very intense management adjustment." That has four parts, she explains: asset sales abroad, individual performance targets for each platform and manager, better maintenance and rigid cost control. Simply introducing scheduled maintenance shutdowns, she says, took "re-education—a new mental model, obvious as it may seem." By the end of the year, every Petrobras employee will receive a signed letter from her setting out the cost-cutting goals.

Investors may wonder why such measures are only now being introduced—and whether, given the political interference, they will be enough. Ana Ares of Fitch, a ratings company, says the crucial test will be whether Ms Foster can negotiate a petrol-price rise. Having to sell imported fuel at a loss puts the firm in the odd position of doing better with lower international oil prices. Another sign will be whether she persuades the government to relax the rigid local-content rules. "The market likes the way Graça talks," says Adriano Pires, an energy consultant. "But realistic goals and good management get you nowhere if your majority shareholder won't let you do what you need to do."

Such meddling can be worryingly myopic. For instance, the anti-inflation drive means that, at the pump, petrol undercuts ethanol, which is not regulated by price (most Brazilian cars can run on any mix of the two). As well as costing Petrobras billions in extra petrol imports, the price differential encouraged Brazilians to stop ▸▸

Murder in São Paulo

Mean streets, revisited

SÃO PAULO

Brazil's biggest city is becoming more dangerous

BETWEEN 1999 and 2011 São Paulo's murder rate fell by almost three-quarters, turning what had been one of Brazil's most dangerous states into one of its safest. Now the violence is rising again. In the past two months more than 300 people have died in the state capital in an undeclared war between police and the Primeiro Comando da Capital (PCC), a drugs gang, twice the tally for the same period last year. More than 90 police officers have been slain since January; the total for 2011 was 56. This year looks certain to close with the state murder rate back at over ten per 100,000 residents: epidemic level.

At first the state government claimed the rise in killings was a blip. It refused to mention the PCC, apparently for fear of glamorising it or causing panic. That made it look complacent. In October the federal justice minister said he had offered São Paulo reinforcements, but been refused. They were not needed, huffed Antonio Ferreira Pinto, the state's prickly security secretary. His federal counterpart, Regina Miki, suggested that São Paulo should learn from Rio de Janeiro, which uses federal forces to expel gangsters from its lawless *favelas* (though Rio's murder rate remains double São Paulo's).

The criticisms have now sparked a response. At the end of October state officials sent extra police into Campo Limpo, Capão Redondo and Paraisópolis, large *favelas* from which they think the PCC has been ordering the murders. On November 7th extra forces arrived in Guarulhos, a nearby city. "Operation Saturation" has already led to scores of arrests as well as to drugs and weapons seizures—and the discovery of a register of officers' names and addresses, thought to be a hit list. Meanwhile officials have at last accepted the federal government's offer to house PCC leaders in distant, high-security jails: one, known as Piauí, who is suspected of ordering the murder of at least six police officers while behind bars, was transferred on November 8th.

On the streets of Paraisópolis, daily life seems little changed by the heavier police presence. But locals confide that after dark they feel, if anything, less safe. A student says that, although he is law-abiding, he fears being stopped by the patrolling ROTA, the state's trigger-happy special forces. "If I'm late now, my mother panics," he says.

State officials say that officers are being murdered at the say-so of drug lords whose profits are being squeezed; those in prison resent being held in separate cells, which constrains their activities. But police are part of the problem, too. On November 13th five officers were arrested after a video surfaced of them shooting a man in their custody. Many of the killings are drive-bys at drug-dealing hotspots: rogue police officers are thought to be behind some of them. The gruesome tit-for-tat is making São Paulo a bloodier place again.

Riding into battle

buying ethanol. That drove domestic investors towards other businesses—which in turn meant Brazil was ill-prepared to capitalise when the United States scrapped tariffs on foreign ethanol at the start of the year. A shift from petrol back to ethanol would be the simplest way to put an end to pricey foreign oil imports, says Ms Foster, and "extremely welcome to Petrobras."

Ms Foster says the board—which is dominated by government-appointed directors—now understands that the firm needs to concentrate on pumping oil if it is to generate the revenues to invest in job-creating refineries and terminals. She rejects the idea that Petrobras is run for Brazil's good, rather than its own. "Petrobras does not see developing the country as its core business," she says. "Not every project that would be great for the country will be undertaken, because not all are economically justified." It is in Brazil's long-term interests, as well as Petrobras's shareholders', that she makes that line stick. ■

Corruption in Quebec

Cleaning up

OTTAWA

Heads start to roll in a Canadian corruption scandal. More may follow

QUEBECKERS were outraged in 2010 when *Maclean's*, a Canadian magazine, labelled their province the most corrupt in the country. True, a Quebec-based scandal had helped to topple the federal government in 2006, and evidence was mounting of bid-rigging and kickbacks in local administrations. But Quebec's defenders claimed that the revelations simply showed their anti-corruption investigators were more vigilant than others. Months of damaging testimony to a corruption inquiry have now left even the province's boosters short of excuses.

The inquiry, headed by France Charbonneau, a justice of the Quebec Superior Court, has this month led to the resignations of Gérald Tremblay, the mayor of Montreal, and Gilles Vaillancourt, mayor of neighbouring Laval. Both still vehemently maintain their innocence, yet had little choice but to go.

Mr Tremblay has not been accused of personal involvement in the kickback scheme—described at the inquiry by two former Montreal engineers—in which the value of construction contracts was fraudulently inflated. The firms involved, some of which are said to have links to the mafia, allegedly gave back some of their remuneration to municipal employees, and made generous donations to political parties. But the racket took place on Mr Tremblay's watch. Martin Dumont, a former organiser for his Union Montréal party, testified that the mayor knew the party kept two sets of books, separating clean and dirty money, but chose to turn a blind eye. Mr Tremblay denies any such knowledge.

Meanwhile Mr Vaillancourt took sick leave and then resigned after anti-corruption police raided his offices. A construction boss told the inquiry that firms were expected to hand over 2.5% of every contract they received in Laval to the mayor. He, too, denies the allegation.

Other heads have already rolled. Four further Montreal employees have been suspended without pay pending further investigations. The mayor of Mascouche and the former mayor of Boisbriand, two smaller cities north of Montreal, were charged with fraud before the inquiry began. And more may yet follow: Ms Charbonneau is due to submit her report in October 2013.

Although the inquiry's mandate is restricted to Quebec, the testimony has also pointed to possible wrongdoing at the fed- ▸▸

eral level and in the neighbouring province of Ontario. Assorted criminologists and police officers have testified about the mafia's sway in Ontario. One theory suggests that the mob there is just as powerful as in Quebec, but is less rancorous than its counterpart and so attracts less attention (as it happens Joseph di Maulo, an alleged kingpin, was shot dead on November 4th in the driveway of his Quebec home). Politicians elsewhere don't seem overly concerned by these insinuations.

None of this means that Canada, which Transparency International, an advocacy group, rated among the world's cleanest countries in its 2011 index of perceptions of corruption, has suddenly become Nigeria. But the episode does suggest that it can no longer be complacent about graft. ■

Bolivia and Chile

Trickle-down diplomacy

LA PAZ

Evo Morales tries to swap a stream for a piece of Chilean seafront

THE Silala (known as the Siloli in Chile) trickles down from Bolivia's unpopulated Andean plateau to the Chilean border. Little more than a ditch in places, the stream is nevertheless the cause of renewed tension in the two countries' already testy relationship.

Much of the Silala's water is consumed in Chile—drunk in the towns of the arid Atacama desert and used in the giant state-owned Chuquicamata copper mine. Chile insists the Silala is an international river and that it has a legal right to use the water. Bolivia has long argued that without the crude stone conduits that help channel the Silala to the border, the water would stay in Bolivian territory. In the latest bout of this long-simmering row, Evo Morales, Bolivia's president, is threatening to reduce the Silala's supply to Chile. Somewhat bizarrely, his plan hinges on fish farming.

Egged on by the central government, local politicians allied to Mr Morales's Movement to Socialism have decided to make use of the water. Last month the governor of the Potosí region, Felíx Gonzales, oversaw a ground-breaking ceremony for the construction of a fish farm supplied from the Silala. The irrigation of land for agriculture and the building of a hydroelectric dam have also been mooted.

All of these projects are economically doubtful. Only tiny amounts of electricity could be produced and there is no one to sell it to. The nearest people live in the village of Quetena Chico, a long drive away (see map). They say the land is too inhospitable for agriculture. Moreover, geological and historical evidence backs Chile's claim that water from the springs has always flowed across the border. Brendan Mulligan, a Canadian water expert, says the Silala clearly travels along an ancient water course: "the channels just make the flow more efficient". A report by Bolivia's own state-run geological service, Sergeotecmin, in 2003, agreed that the water follows a natural drainage course.

In truth the impasse is about more than the Silala. It is intimately linked to another and much larger body of disputed water: the Pacific Ocean. Since Chile annexed Bolivia's sea coast in the 19th century, Bolivian politicians of all persuasions have cultivated antagonism towards Chile. The grievance is reinforced by an annual "Day of the Sea". The slogan "Reclaim the Sea" was for years painted above the doors to customs facilities and printed on the spine of the La Paz phone book.

In a speech last year Mr Morales described the loss of the coastline as "an open wound". He signed a decree creating the Strategic Unit for Maritime Claims, which is charged with co-ordinating Bolivia's bid to achieve access to the sea (without conspicuous success so far). The Silala gambit looks like a renewed effort to turn the screws on Chile over maritime access.

It stands no chance of convincing Chile to cave into Bolivia's demands for a chunk of its coast. On the other hand, cooler presidential talk might eventually lead to an improvement in the conditions for Bolivia's trade through Chilean ports. An end to Bolivia's refusal to sell its abundant supplies of natural gas to its energy-hungry neighbour might help, too.

Still, the ruse does have enormous potential to galvanise domestic animosity towards Chile and to boost the president's popularity. It will thereby help to deflect criticism of Mr Morales for having unilaterally abandoned wide-ranging talks with Chile last year, and for his failure to make good his frequent threat to take Chile to an international court over Bolivia's landlocked status. ■

Cuban health care

Nip and tuck in

HAVANA

Medicine is big business in Cuba

SET in a former naval academy overlooking the Florida Straits, the Latin American School of Medicine (ELAM) is supposed to symbolise Cuba's generosity. Founded by Fidel Castro in 1999, the school's mission was to provide free training to medical students from all over the world. But these days, visiting foreign dignitaries are given a sales pitch along with their campus tours.

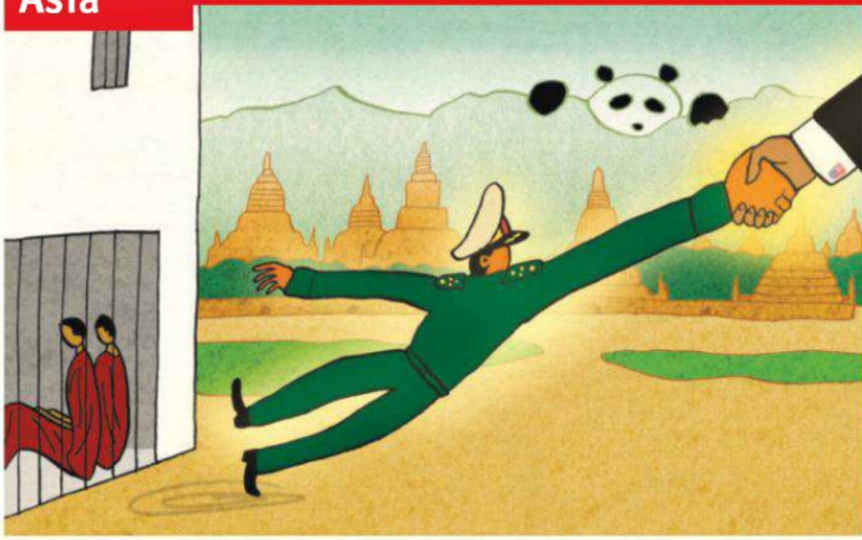
As part of President Raúl Castro's attempt to stem his brother's spending, many nations that send students to the school are now expected to pay. Just how much isn't entirely clear, but the rates are high enough to cause embarrassment to some of the customers. John Mahama, Ghana's new president and a staunch ally of Cuba, has been obliged to defend what looks like a pricey deal he signed with ELAM as vice-president.

Cuba's government has never been coy about the sale of its medical services abroad. Official figures show that professionals working overseas—largely in medicine—bring in around $6 billion a year (though the doctors themselves receive only a small fraction of the revenue). Most of that comes from Venezuela, which trades subsidised oil for legions of Cuban health workers. But reports in Namibia suggest that prices for services there are rising, too.

In Cuba itself, meanwhile, private medicine is readily available to paying foreigners and well-connected locals. The two best hospitals in Havana, Cira García and CIMEX, are run for profit. Both are far better than normal state hospitals, where patients are often obliged to bring their own sheets and food.

But health care is now also available on the buoyant black market. A current vogue for breast implants is providing extra income to many surgeons (whose state salary is around $20 a month). The director of one of Havana's main hospitals was recently detained for running a private health network on the side. Alongside the new restaurants that are opening in the capital, as a result of Raúl Castro's partial easing of economic restrictions, doctors are now less shy about selling their services. One private dental practice in the Vedado district is notably well-equipped with a snazzy dentist's chair and implements.

These medical entrepreneurs run the risk of prosecution. If caught, they may be tempted to argue that they are simply following the government's example.



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Myanmar and America

Goodbye clenched fist, hello sweaty palm

BEIJING, SINGAPORE AND YANGON

President Barack Obama makes an unprecedented visit to a former pariah

HE WILL be on the ground for less than a day. Still, when Barack Obama arrives in Myanmar on November 19th, one leg of a three-country South-East Asian tour, it will be quite a moment: the first ever visit to the country by a sitting American president, which sets the seal on one of the fastest rehabilitations of a former American foe.

Not that long ago America was branding Myanmar an "outpost of tyranny", and an "unusual and extraordinary threat to the national security and foreign policy of the United States". But that was before Aung San Suu Kyi was released from years of house arrest in late 2010 and, the following year, the new president, Thein Sein, promised to take his country down the path of opening and reform. These days, it is all friendliness between the two sides. Yet the fact that only a couple of months ago Mr Thein Sein's name had hastily to be removed from a long-standing visa blacklist in order to meet his new friends in the Obama administration in New York shows how swiftly events have moved.

Too swift, for some. Mr Obama says he is going to Myanmar in order to reward the regime for the democratic changes of the past two years, and to encourage further reform. Some activists and Burmese exiles are critical of his rush. They acknowledge Myanmar's progress to date, but argue that it is premature for an American president to confer the honour of a visit on a regime that still holds political prisoners and prosecutes nasty little wars against its own people, such as the ethnic Kachin.

Then there is the more recent outbreak of sectarian violence in Rakhine state in the country's west, the brunt of which is borne by the Muslim Rohingya minority. Since fighting erupted in June the conflict has cost hundreds of lives and left over 130,000 homeless. The inability—or unwillingness—of the government to stem the attacks on the Rohingya, a stateless people though most have lived in the country for generations, has raised doubts as to whether the regime is really changing its spots with respect to human rights and the ethnic divisions within the country.

Similar concerns animate complaints about another leg of Mr Obama's brief tour, to Cambodia. He will be in Phnom Penh on November 19th and 20th to attend the annual East Asia Summit. But many, including both Republican and Democratic congressmen, question the wisdom of appearing too close to the country's strongman, Hun Sen, who has ruled with an iron fist for almost three decades (see Banyan). Only in Thailand, which he also visits, will Mr Obama court less controversy.

Trumping the concerns, however, is America's "pivot" towards Asia and the geopolitical contest for friends and influence in the face of a rising China. Myanmar, which shares a 2,000-kilometre (1,250-mile) border with China, is viewed as a crucial prize in this contest. Mr Obama hotfooting it to Myanmar throws out an unequivocal message of American intent.

The visit will also be used to justify the more conciliatory foreign policy that he promised in his inauguration speech in January 2009, following his bellicose predecessor, George W. Bush. Then, Mr Obama offered to extend a hand to pariah regimes that were "willing to unclench" their fists. The policy yielded little in North Korea and Iran, but at least Mr Obama has a sweaty palm to clasp in Myanmar.

Before, America had focused on isolating the military regime with comprehensive economic sanctions, introduced after the repression of the democracy movement in the early 1990s and the house arrest of its leader, Miss Suu Kyi. The Obama administration promised to uphold the sanctions but also to talk directly to the Burmese leadership, with the blessing of Miss Suu Kyi.

This "pragmatic engagement" has undoubtedly yielded results. American visits and offers of help have been matched by concessions by the regime: prisoner releases (another occurred just before Mr Obama's arrival), free and fair by-elections, the relaxation of media censorship. The pace of change quickened after the visit of the secretary of state, Hillary Clinton, late last year. Importantly for America, Mr Thein Sein has renounced military links with North Korea.

It helped that Myanmar's ruling generals really wanted to engage. Their pariah status in the West, and a decrepit economy, were immense humiliations when rubbing shoulders with fellow South-East Asians. They also wanted to end their growing reliance on China. As Americans realised that sanctions had simply driven Myanmar into China's arms, so the generals increasingly resented the embrace. Chinese businesses were coming to dominate, especially in Myanmar's north, which the Chinese were tearing up to make way for unpopular development projects. And so both America and Myanmar had good reasons to help each other.

As the United States seeks to deepen ties in the neighbourhood, China, for its part, has been strangely quiet about Myan- ▸▸

mar's reorientation towards the West. Perhaps that is because the country is important to China above all for future transhipments of gas, the plans for which are still going ahead, with a pipeline under construction. As for Miss Suu Kyi, many Chinese hardly know about her. But as she rises to prominence that will change. Her anglophile tendencies, and a late husband who cared passionately about preserving Tibetan culture, will do nothing to allay growing Chinese suspicions of her.

Meanwhile, foreign-policy experts in China refuse to be taken in by all the American rhetoric about democracy and human rights. America, complains Zhu Feng, an international-relations specialist at Peking University, always had a strategic concern with China in the region, assuming that it wants to use "Myanmar as a springboard to the Indian Ocean". (That is a not unreasonable assumption.)

And so the Obama visit is likely only to deepen the Chinese feeling of creeping encirclement. Chinese experts also point to last month's extraordinary announcement that next year the Burmese army will, as observers, probably attend America's annual regional military exercises with its friends, known as Cobra Gold. This year's event, in Thailand, included contingents from South Korea, Indonesia, Japan and Singapore. If the Burmese join this lot, then expect the more conspiratorial readings of the "pivot" to get a really good airing in the Chinese capital. ■

Constitutional crisis in Nepal

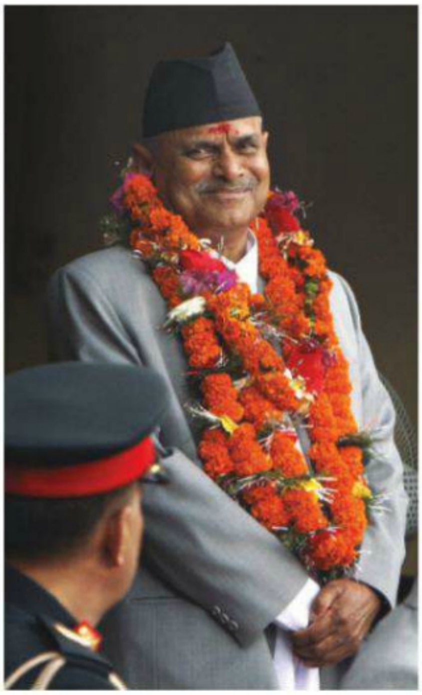
Ceremonial time

KATHMANDU

As the government fails to hold promised elections, speculation grows about how the president will act

THE country's largely ceremonial president, Ram Baran Yadav, denies it. Yet diplomats and political insiders in Kathmandu accept that earlier this month Mr Yadav sounded out the army chief as well as the Indian ambassador about toppling the government of Nepal on November 22nd. The response he received obliged him to shelve his plans.

Even the president's advisers admit that he is keen to dispose of the Maoist-led government of the prime minister, Baburam Bhattarai. The trouble, they say, is that under Nepal's interim constitution he has no power to do so. Ever in thrall to conspiracy theories, the capital is more than usually abuzz with speculation about how the president will act.



Yadav: the effective opposition

In May an assembly elected in 2008 to write a new democratic constitution lapsed without completing its task. That plunged the country into renewed crisis. The interim constitution has no provision for holding fresh elections, nor for replacing the government. At the time Mr Bhattarai called for fresh elections to be held on November 22nd. But the opposition parties refused to co-operate over the electoral arrangements, and the president rejected two government ordinances on election rules. Politics is polarised. Mr Yadav believes that as the poll date passes the government will have no legitimacy, and so must go.

To critics of the Maoists, the party is undemocratic and threatening, responsible for sowing division in Nepali society. Mr Yadav is supposed to be neutral, but stands with these critics. Indeed supporters credit him with proving a more effective opposition than the weak and fractious Nepali Congress Party, to which he once belonged. The Maoists, who won the last election and have transformed themselves from a rural militia into a mainstream party, accuse critics of trying to thwart social changes that many voters demand.

As ever, personal ambition and a struggle for state resources play big parts in the crisis. But also at stake is the conduct of the next election, with potentially far-reaching consequences for the constitution that may eventually emerge.

The president's preferred solution is said to be to install a "neutral" government, possibly under the leadership of a former chief justice, to oversee elections. Mr Yadav appears to believe that such a move would be popular; and that the Maoists, who are committed to fresh elections, would have little choice but to go along.

But would not dealing with the government offer better prospects of progress than trying to topple it? Little suggests that an administration installed by presidential coup would in fact be in a better position to broker a deal.

To intervene, as few doubt he wishes to, the president would have to assemble a coalition, including opposition parties whose leaders have hopes of becoming prime minister. He would also need the nod from the army and from India, Nepal's powerful neighbour which still calls the shots. The logistical timetable for elections next year is already in doubt, if the monsoon season is to be dodged. And so the politics of conspiracy will have full rein.

A precedent exists for Nepal's precarious situation. In 2002 a prime minister failed to hold elections, causing the then ceremonial monarch to sack him. The king enjoyed brief and shallow public support. Four years and four royally appointed governments later, the monarchy was defeated by a mass street movement, ushering in a ceremonial presidency. Do not wish the chaos of the past decade on Nepal again. ■

Taiwan politics

Ma the bumbler

TAIPEI

A former heart-throb loses his shine

WHEN he was first elected in 2008, Taiwan's president, Ma Ying-jeou, offered Taiwanese high hopes that the island's economy would open a new chapter. He promised ground-breaking agreements with China to help end Taiwan's growing economic marginalisation. At the time, Mr Ma's image was of a clean technocrat able to rise above the cronyism and infighting of his party, the Kuomintang (KMT). He was a welcome contrast to his fiery and pro-independence predecessor, Chen Shui-bian, now in jail for corruption.

Five years on, and despite being handily re-elected ten months ago, much has changed. In particular, popular satisfaction with Mr Ma has plummeted, to a record low of 13%, according to the TVBS Poll Cen-

tre. The country appears to agree on one thing: Mr Ma is an ineffectual bumbler.

Ordinary people do not find their livelihoods improving. Salaries have stagnated for a decade. The most visible impact of more open ties with China, which include a free-trade agreement, has been property speculation in anticipation of a flood of mainland money. Housing in former working-class areas on the edge of Taipei, the capital, now costs up to to 40 times the average annual wage of $15,400. The number of families below the poverty line has leapt. Labour activists have taken to pelting the presidential office with eggs.

Exports account for 70% of GDP. So some of Taiwan's problems are down to the dismal state of rich-world economies. Yet Mr Ma's leadership is also to blame. He has failed to paint a more hopeful future, with sometimes hard measures needed now. Worse, he frequently tweaks policies in response to opposition or media criticism. It suggests indecisiveness.

Public anger first arose in June, when Mr Ma raised the price of government-subsidised electricity. Few Taiwanese understood why, even though Taiwan's state-owned power company loses billions. In the face of public outrage, Mr Ma postponed a second round of electricity price rises scheduled for December. They will now take place later next year.

People are also worried that a national pension scheme is on course for bankruptcy in less than two decades. Yet Mr Ma cannot bring himself to raise premiums sharply, because of the temporary unpopularity it risks. When Mr Ma does try to appeal to Taiwanese who make up the island's broad political centre, it often backfires with his party's core supporters. Following public grumbles that retired civil servants, teachers and ex-servicemen were a privileged group, the cabinet announced plans to cut more than $300m in year-end bonuses, affecting around 381,000. The trouble was, veterans are among the KMT's most fervent backers. Now some threaten to take to the streets in protest and deprive the KMT of their votes until the plan is scrapped. Meanwhile, Mr Ma's clean image has been sullied by the indictment of the cabinet secretary-general for graft.

Cracks are starting to grow in the KMT façade. Recently Sean Lien, a prominent politician, criticised Mr Ma's economic policies, saying that any politician in office during this time of sluggish growth was at best a "master of a beggar clan"—implying a country of paupers.

But the next election is four years away, and presidential hopefuls will not try to oust or even outshine Mr Ma anytime soon. After all, they will not want to take responsibility for the country's economic problems. Nothing suggests Mr Ma's main policies will change (or that they should), but his credibility is draining by the day. ■

Politics in Japan

The Kamikaze election

TOKYO

As the economy sinks, the prime minister appears ready to go down with it

THE prime minister, Yoshihiko Noda, has suddenly settled a question that has hung over Japanese politics since the summer. He has promised to dissolve the lower house of the Diet, or parliament, on November 16th—so as to hold a general election exactly a month later.

The move was greeted with glee by Shinzo Abe, who hopes to lead the opposition Liberal Democratic Party (LDP) back to the position of power it occupied for nearly all of the 55 years to 2009. It raises another big question for Mr Noda, though. Why hold an election, so soon, that polls suggest he is bound to lose?

The answer reveals a lot about the prime minister, a man who seems prepared to take his party down in flames in order to do what he thinks is the right thing. Many within the ruling Democratic Party of Japan (DPJ) had urged him to cling to power for as long as possible, hoping that Mr Abe, who fluffed the job of prime minister from 2006-07, would stumble again in opposition.

Yet Mr Noda (pictured above, right) overrode their objections and set only two conditions for dissolving parliament. First, he wants the LDP-led opposition to join the DPJ in voting in the Diet to issue bonds that would cover the budget deficit—and so avoid Japan's version of the "fiscal cliff". The opposition has already agreed to that.

Secondly, he wants a commitment in the next parliament to reduce the number of MPs. Japan needs to redraw the electoral map after the election, in order to avoid a constitutional crisis related to voting disparities between heavily populated and depopulated areas. For Mr Abe (pictured, left), that appears a small price to pay for something the LDP craves: a return to power.

Standing opposite Mr Abe in a face-to-face debate in the Diet, Mr Noda sought to justify his timing by declaring that he was honest. He had made a promise in August to the LDP that he would dissolve parliament "soon", and he intended to stick to it. Those who know him say that he is also driven by a desire to make tough decisions about Japan's future, however unpopular they appear to members of his party.

Earlier this year he persuaded the DPJ and the LDP to join forces to raise the consumption tax (a tax on sales), starting in 2014, even though this went against his party's 2009 election manifesto. The deficit-financing bill will apply until 2015, such that future governments will not be hijacked by the issue as the DPJ has been.

Some decisions confound those in his own party who have seen his government's support plunge to 18%, according to the latest poll. They also fear holding an election during what may be the start of Japan's third economic recession in four years. On November 12th it was reported that GDP in the third quarter fell by 0.9% compared with the previous three months. ▸▸

Fourth-quarter data augur ill, too.

If that were not bad enough, many colleagues also fear that Mr Noda will campaign to take Japan into negotiations on a free-trade deal with America and ten other countries, known as the Trans-Pacific Partnership (TPP). Though on November 13th a poll in the *Asahi Shimbun*, a newspaper, said 48% of those surveyed approved of the TPP, it is a highly controversial issue whose opponents shout much louder than its supporters. Mr Noda's hopes of making the TPP an election issue were bolstered on November 15th, when Mr Abe, whose party panders to protected rice farmers, appreared to soften his opposition. He said he may support TPP if Japan can exclude some items from the negotiations.

Mr Noda may not be all lofty ideals. There may be a smidgen of political calculus there. A swift election would make it hard for Japan's array of smaller "third" parties to band together and pose a serious challenge. And it would give Mr Abe a chance to mess things up in government before an upper-house election due by the end of July. Some speculate that Mr Noda may have a plan up his sleeve later to forge an alliance of pro-TPP types from both main parties.

In the meantime, though, Mr Noda appears to be on the verge of handing power on a plate back to an LDP that has barely reformed itself since it was driven out in disgrace three years ago. That, for all his good intentions, would be a legacy of failure. ■

Development in India

A tale of two villages

KAILASHPUR, CHHATTISGARH AND MAHESHPUR, UTTAR PRADESH

In rural India there is hope that the worst policies can be improved

A PAINTED milestone marks the turn-off to Kailashpur. The slab sports a poor likeness of Gandhi and announces "The Mahatma Gandhi National Rural Employment Guarantee Scheme. Rural road constructed from the curve at Pansara to Kailashpur forest road. Sanctioned: 2007-08. Cost: 4.3m rupees [$80,000]."

The road winds a few miles through the jungle and ends at the village's new primary school, gaily painted with a rainbow, Tom and Jerry, and Mickey Mouse. The schoolteacher, Solomon Ming, busily shepherds his little charges back to their schoolroom after a free lunch. Outside, villagers trudge painstakingly back from the nearest town, balancing on their heads bundles of firewood each the size of desks. Inside, the girls chatter excitedly about new satchels which had arrived that morning. They came from the Chhattisgarh state government, and only the girls got them, for they are intended as inducements to boost female literacy. On the wall are a list of the 85 children at the school and details of the three teachers, their qualifications and when they started work. Another sign outside says "National Rural Employment Guarantee Act. Cost of levelling ground for a school: 25,000 rupees."

Kailashpur: the home where buffalo roam

It is all evidence of a quiet upheaval in Chhattisgarh, a state in central India. Over the past few years, the government in the capital, Raipur, 200 miles (320 kilometres) away, has been trying to improve India's notoriously corrupt and ineffective social-safety nets. The system provides cheap food and make-work schemes for the poor. Yet a huge chunk of the money never reaches the intended beneficiaries. Determined to change that, the state government insisted the schemes be transparent and that people should know what the projects were up to. Hence the signs.

A hundred miles away in Maheshpur, in the neighbouring state of Uttar Pradesh, there are no such signs—and little to describe even if there were. The primary school is a patch of bare earth protected by a tarpaulin strung between trees. The children are at home because the teacher, from a nearby town, has not appeared. A few dredged ponds and levelled footpaths are the only products of make-work schemes.

Maheshpur is on the dusty plain and grows maize and lentils. Kailashpur sits at the base of lush hills, and villagers there plough rice paddies with buffalo. Yet in many respects, both are typical of tens of thousands of villages in central India. Each has about 500 households, and is dominated by marginal groups: mostly *Dalits*, the former untouchables, in Maheshpur, while in Kailashpur most villagers are *Adivasis*, or so-called scheduled tribes, the aboriginal population of India.

Crucially, though, the fact that the two villages are in different states means that their poverty is dealt with differently. In India state governments usually have more impact on the lives of poor people than does the national government. In theory, the country has an extensive system of social protection which, though people are rarely left to beg and starve, often fails the poorest. Recently, Jean Drèze of Allahabad University argues, the system has been improving, though not everywhere, nor at the same rate. Maheshpur and Kailashpur illustrate the discrepancies.

Pick a card, any card

India's main social-protection programmes are the Public Distribution System (PDS) which provides cheap food, and the National Rural Employment Guarantee Act, which provides up to 100 days of paid work to any rural household that asks for it. Both require identity cards. The number of cards in each state is determined nationally, based on a household survey conducted in 2002. But the number of cards in each village is fixed by state governments, which may add benefits on top of the national ones. The decision about which individuals get the cards is local, too.

Gulshan, a stick-thin labourer in his ▸▸


Maheshpur: card confusion

50s, throws three cards down onto the divan outside his mud house in Maheshpur. Each is a dog-eared booklet, messily filled in to show purchases at the PDS shop. The cards belong to his two sons. One has died and the other has moved away, but Mr Gulshan uses the cards to feed his family. Urmila, the son's widow, says that without cheap food her sons would go hungry. She worries about how long she will be allowed to keep her late husband's card and whether she will ever get one of her own.

Three sorts of card exist in Maheshpur: one for those above the poverty line but who still need help; one for those below the poverty line (BPL); and one for the very poorest, which carries a bigger subsidy. In Uttar Pradesh, BPL holders can buy 20kg of rice a month at 6.15 rupees a kilo and 15kg of wheat at 4.65 rupees a kilo. Mr Gulshan's are BPL cards, but he is unsure how much he is entitled to. Anyway, he says, sometimes nothing is available in the PDS shop. Confusion surrounds the cards. In theory everyone with a BPL card should be on a list. But some people who have cards are not on the list, and some who are on the list do not have cards. So coverage is patchy. For instance, Maheshpur has 179 BPL cardholders but villagers say there should be at least 500-600.

In Kailashpur Sabur Sai also has three cards: for his wife, daughter, and wife's sister. Chhattisgarh has an even more complicated system than Uttar Pradesh: there are six, colour-coded cards, including special ones for widows and pensioners. Yet the basic entitlement is common to all and, unlike in Maheshpur, everyone knows it: 35kg of rice and 10kg of wheat (and "not a single grain less", says Mr Sabur Sai), each for 2 rupees a kilo. Subsidised grain therefore costs less than half what it does in Uttar Pradesh. Mr Sabur Sai says he has stopped herding goats for others and has bought 40 of his own, several of which are nosing about his courtyard and knocking over furniture. Because he can keep an eye on them while working on his smallholding, his farm has flourished. He gestures to the other side of the valley where his brother-in-law is knee-deep in mud behind a buffalo, ploughing a field that once lay fallow.

Expanding safety nets does not have to be expensive: spending on cheap food is only 4% of Chhattisgarh's budget. But by itself expansion would not have done much. Theft from anti-poverty programmes—reselling subsidised food and pocketing the difference—is endemic. An investigation by Bloomberg, a news agency, reckoned that $14.5 billion worth of food has been ripped off from the PDS in Uttar Pradesh alone in the past ten years.

The fraudsters operate with impunity, and expanding the programmes risks expanding corruption. So the Chhattisgarh government changed the system. The hope was that if beneficiaries knew what they were entitled to, they would kick up a fuss when money or food went missing. Millions of beneficiaries outnumber a few bribable civil servants.

Half the houses in Kailashpur have a small yellow plaque by the front door with the name and number of PDS cardholders living there. The walls of the village shop are also covered by names and numbers—the names of card holders, the prices of sugar and cereals, even a toll-free number in case of complaint. Local watchdog organisations say complaints through the helplines usually lead to some sort of redress. According to Reetika Khera, of the Indian Institute of Technology in Delhi, only 10% of PDS shops in Chhattisgarh reported that food had gone missing or been stolen in 2009-10, down from almost half in 2004-05. In Uttar Pradesh the theft rate remains stuck at about 60%.

The bigger change in Chhattisgarh was to the role of the middlemen who take food from government warehouses, transport it to villages and sell it. In Uttar Pradesh such middlemen are private dealers. Partly because they are not paid properly, they bilk the system and get away with it, thanks to political contacts.

There is no evidence that the shopkeeper in Maheshpur, Radhe Shyam Singh, is corrupt, but his background is typical. He has run the local PDS for nearly a quarter of a century, having got the job thanks to a political connection. In 1990 a member of his high-status Rajput caste was elected to the head of the council, or *sarpanch*. Along with the job, Mr Singh got a bank loan to finance start-up costs. He has not looked back. Most houses in the village have a couple of bare light bulbs. His is lit up like a Christmas tree and sports a satellite dish. Four buffaloes graze placidly out front, next to a rank of his motorcycles.

Cutting out the middleman

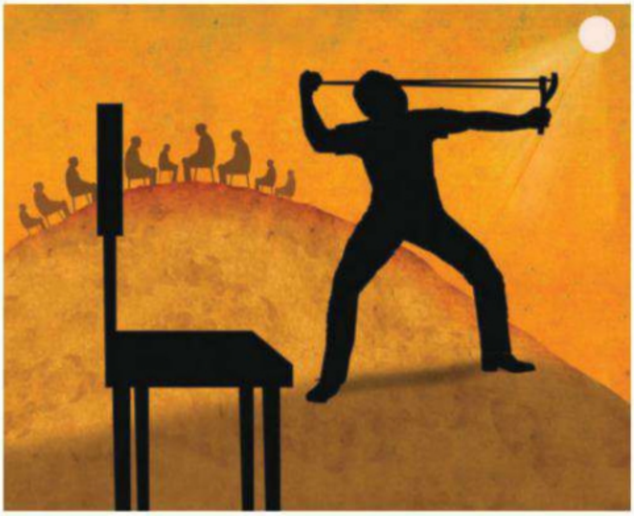
In Kailashpur his opposite number is Chintamani Singh, another Rajput. Yet he is not a private dealer. In the mid-2000s the Chhattisgarh government nationalised the distribution bit of the Public Distribution System and handed it over to local institutions or self-help groups. The main aim was political: to win village votes by improving social-safety nets. The move provoked a fierce fight that went all the way to the Supreme Court in Delhi, as dealers sought to protect their lucrative businesses. They lost. According to one survey, 97% of respondents in Chhattisgarh say they normally get their full entitlement of food, compared with only 77% in Uttar Pradesh. A spot check of shops showed that shop records and ration-card entries matched in 94% of cases in Chhattisgarh, but only half the time in Uttar Pradesh.

Though Kailashpur has none of the obvious attributes of wealth—it has no rural industry or large shops, for instance—its people seem better fed and better housed than in Maheshpur. Mr Drèze reckons that whereas the PDS has reduced the number of people below the poverty line by 15% in Uttar Pradesh, it has done so by 40% in Chhattisgarh. Two things, says Mr Singh, the PDS manager in Kailashpur, have got better over the past five years. The first is the government's greater attention to programmes such as the PDS. Second, ordinary folk are better informed, and these days insist on their rights. "Sometimes", Mr Singh says, "we can barely keep up." ■

Correction: In our story on the woeful damming of the Mekong ("River Elegy", November 3rd) we said that the World Bank had blacklisted the Finnish parent company of Pöyry for corruption. In fact, only a subsidiary, Pöyry Management Consulting Oy, was banned from doing business with the Bank. We are sorry.

Banyan | Tenth out of ten

A few days at centre stage for Hun Sen, Cambodia's dictator, may not be entirely welcome



THE ten-member Association of South-East Asian Nations (ASEAN) is used to fending off "interference" by the West in the internal affairs of some of its members. In recent years the human-rights record of the regime in Myanmar has been the tenderest of these sore spots. But as ASEAN's leaders gather in Phnom Penh, capital of Cambodia, for their annual summit between November 18th and 20th, Myanmar, liberalising and opening up, finds itself flavour of the month in the West. Instead, it is the host country that is now the butt of more criticism.

Since Cambodia joined ASEAN in 1999, Phnom Penh has grown from a quaint backwater into a bustling city. The economy, thanks in part to garment exports, is growing at a steady 6% a year. Hun Sen, Cambodia's prime minister, has a lot to show off at the East Asia summit, held alongside ASEAN's get-together, and drawing Barack Obama and other world leaders. It caps Cambodia's year in ASEAN's rotating chair, and Phnom Penh is being spruced up. Beggars and hawkers are being moved, anyone thinking of a street protest has been told to think again, and eight people were detained on November 15th when they protested on a roof instead with a picture of Mr Obama and a message reading "SOS". NGOs had to cancel planned events as venues withdrew. But Mr Hun Sen's reputation does not scrub up quite so easily.

ASEAN is still smarting from the debacle of its annual security forum and foreign ministers' meeting in Phnom Penh in July. For the first time its members could not agree on a joint communiqué. The Philippines and Vietnam wanted references to their disputes with China in the South China Sea. Cambodia, apparently at China's behest, objected. Mr Hun Sen, it was felt, was now in the pocket of China, which in September announced $500m in soft loans to Cambodia. The row drags on. Cambodia's ambassador to the Philippines had to be withdrawn from Manila after carrying it on in the press and is yet to be replaced. This is Cambodia's second serious falling out with one of ASEAN's "core" founder members. Last year Cambodia and Thailand lobbed shells at each others' troops over a disputed bit of their border.

For human-rights critics, the summits offer a chance to remind the world of Mr Hun Sen's ruthless record. A former Khmer Rouge, he emerged in the Vietnamese-backed regime that rebuilt Cambodia from the ruins left by the Pol Pot terror of 1975-79. In 1985 he became prime minister of a one-party state on the Vietnamese communist model. After the Paris peace agreements of 1991, the United Nations tried to plant a multiparty democracy in this infertile soil. Ever since, Mr Hun Sen has seemed to be trying to hoe away its traces, like so many weeds. Having lost the first election, in 1993, he muscled his way into a power-sharing deal. Sharing power, however, is not Mr Hun Sen's style, and in 1997 he staged a coup.

Most of the villages, where four-fifths of Cambodia's 14m people live, have schools bearing his name, along with offices of his Cambodian People's Party (CPP). The CPP is almost as dominant as in the one-party days, and has made Mr Hun Sen Asia's longest-serving leader. The party controls most of the media and it harasses the opposition, whose leading figure, Sam Rainsy, facing 11 years in jail on various dubious charges, has exiled himself.

A new report by Human Rights Watch, a New York-based campaign group, calculates that since 1991 more than 300 people have been killed in political attacks. The CPP has easily won elections, even without stuffing ballot boxes. The opposition, now called the National Rescue Party, a recent merger of the Sam Rainsy Party (SRP) and another, has threatened to boycott the next vote in July 2013 unless Mr Rainsy can compete (unlikely: he has been stripped of his vote) and if the election commission is not given independence. In fact, opposition members suggest a boycott would be very much a last resort.

Some analysts blame the looming election for a recent crackdown. Mam Sonando, a well-known journalist critical of Mr Hun Sen, was last month sentenced to 20 years in prison, for leading an "insurrection" in April, for which 13 women had also been jailed. The alleged uprising was actually a protest against a land grab, in which a 14-year-old girl was shot dead by the authorities.

Land grabs—or the enforcement of "economic land concessions"—are the other big human-rights concern clouding Mr Hun Sen's day in the sun. In principle a sensible idea to bring economies of scale to the countryside by selling farmland, these have become a nightmare of abusive, uncompensated eviction. Protests have been violently suppressed and activists murdered. A moratorium on land concessions has been in force since May, as a land-titling exercise is undertaken. Yet concerned NGOs and businessmen alike see this as a sham. Evictions continue on concessions deemed already in the approval process.

Everything but fair

In late October a dozen American congressmen wrote to Mr Obama urging him to take Mr Hun Sen to task in Phnom Penh. The European Parliament is calling for an end to the land concessions and a release of political prisoners. A campaign to remove Cambodia's "everything but arms" duty-free access to the EU is gathering steam. A particular target is "blood sugar"—Cambodian sugarcane allegedly produced on grabbed land. Myanmar is in the process of regaining these tariff privileges. When it does, it could be a big competitor to Cambodia's garment industry.

Mr Hun Sen must find all this terribly unjust. In terms of its infrastructure, regulation and political stability, Cambodia is far better placed to receive foreign investment than is Myanmar. And it is free of the hideous ethnic cleansing seen in Myanmar's Rakhine state last month. Other ASEAN countries—Brunei, Laos, Vietnam—flout democratic principles with, apparently, far less opprobrium. Yet that is the lesson Mr Hun Sen has spent three decades drumming into Cambodia's opposition: life is unfair. ■

China's leaders

Changing guard

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BEIJING

China shuffles its leadership, putting a "princeling" in command

FOR the first time since the death of Mao Zedong in 1976, China's most important reins of power have been handed over at the same time to a single man: Xi Jinping (pictured, centre, above). The decision, revealed on November 15th, that Hu Jintao has stepped down not only as the Communist Party's general secretary, but also as head of China's army, was part of the biggest shake-up of the party's leadership in a decade. But, although Mr Xi now has the titles of power, his ability to use them will be heavily constrained.

That Mr Xi, who is 59, would succeed Mr Hu as party chief has been in little doubt since 2007. There was also little doubt that one day he would take over Mr Hu's other important position as chairman of the party's Central Military Commission, which controls the armed forces. But it was uncertain until the announcement was made whether Mr Hu would relinquish both titles at the same time.

Mr Hu is constitutionally obliged to step down from his other post, as China's president, next March, but that is a far less substantial job. His predecessors, Jiang Zemin and the late Deng Xiaoping, both kept the military post for a couple of years after leaving the Politburo, ostensibly to ensure a smooth transition. Not since Hua Guofeng took over on Mao's death have both jobs been transferred simultaneously.

Hua turned out to be little more than a transitional figure. Few people expect Mr Xi to be the same. But his new jobs by no means give him absolute power. Crucially, his two predecessors, Mr Hu and Mr Jiang, are still alive. Both will wield considerable influence: Mr Jiang, at the age of 86, probably even more than the 69-year-old Mr Hu. The membership of the Politburo Standing Committee, the party's ruling body, bears Mr Jiang's imprint. Mr Xi and the man expected to succeed Wen Jiabao as prime minister next March, Li Keqiang, are the only two left from the outgoing committee, which has been reduced from nine members to seven. Of the five newcomers, all but one are considered to be protégés of Mr Jiang.

This is unlikely to displease Mr Xi, himself counted a Jiang-ist. Mr Li will be less enthused. Many observers believe that at one time Mr Hu was keen Mr Li should succeed him, not Mr Xi. As prime minister, Mr Li's chief responsibility will be overseeing the economy. But he might find it difficult to get his way given the presence of two others in the standing committee who are Jiang's men. One is Wang Qishan, who has played a central role in economic management for more than four years, and has now acquired a very powerful role as the party's chief anti-corruption official. The other is Zhang Gaoli, the party leader in the port city of Tianjin, who is expected to take over Mr Wang's economic portfolio.

The body's new membership does not suggest any clear policy shift. Reformers will be disappointed at the omission of two men once thought frontrunners for elevation: the party chief of Guangdong province, Wang Yang, and the head of the party's Organisation Department, Li Yuanchao. Both are seen as Mr Hu's men and are reputed to be relatively liberal.

None of this necessarily means that Mr Xi will shy away from economic, or even political, reforms. Mr Hu has been widely criticised by liberals in China for letting reforms stagnate, especially in his second term. Some allow themselves a smidgen of hope that Mr Xi may prove bolder. As a "princeling", the child of a senior leader, Mr Xi is assumed to be rather more self-confident than Mr Hu. His father was close to Mao (until he fell out with him), as well as to Deng. This gives Mr Xi clout that Mr Hu, a commoner, lacked in his dealings with China's ruling families.

Mr Xi offered little evidence of such confidence, however, in his remarks to journalists after the rubber-stamping of his appointment by the party's newly chosen 376-member central committee. He seemed relaxed and upbeat in his delivery (in the purest Mandarin tones of any of China's supreme leaders since the party came to power in 1949). But his comments were bland. After a year of huge scandal, involving the purge of a Politburo member, Bo Xilai, for alleged corruption and complicity in the cover-up of a murder, Mr Xi referred only briefly to the "serious challenges" the party now faces, including that of corruption and becoming "divorced from the people". He took no questions.

The party's worries about Mr Bo's unusually populist approach may explain why the new standing committee is filled with conformist faces. One is Zhang Dejiang, who took over from Mr Bo as party chief of the south-western region of Chongqing. Mr Zhang, a likely new head of the legislature, is thought to be relatively conservative. So are two other new appointees: Liu Yunshan, the party's propaganda chief (a Hu-ist); and Yu Zhengsheng, party chief in Shanghai, who trained as a ▸▸

missile engineer. As many as four of the seven leaders are deemed princelings.

China's kingmakers may have decided to play safe for now, but leadership issues will again loom large in 2017 when the party's next five-yearly congress is due to be held. By then the newcomers to the standing committee will be considered too old to carry on (all of them are in their mid-to-late 60s). Some of the powerful elders might have faded from the scene. Mr Xi and Li Keqiang might then have a freer hand to promote their own people, and perhaps more daring ones. If, that is, they manage to keep control until then. ■

Microblogs and the party

The naked emperor

BEIJING

China's leaders try to steer online discussions using clever propaganda

ON NOVEMBER 9th the official microblog of *People's Daily*, the main mouthpiece of the Communist Party, posted a message about the party's five-yearly congress to the account's nearly 3m followers on Sina Weibo, China's equivalent of Twitter. It was by no means standard propaganda: "The ruling party must remember: the sense of crisis comes first, and reforms must race to stay ahead of crisis. Time is running out."

Six days later the party completed its first succession of top leaders in the era of microblogs, or even of mass public connection to the internet (there were only 50m internet users in China a decade ago, compared with more than 500m now). The turgid display of Leninism at the party congress met with obligatory enthusiasm from delegates, but this time also met with merciless cynicism online. When one congress delegate said she "wept five times" during President Hu Jintao's opening speech, microbloggers traded jokes about having "wept five times" upon, for example, eating a spicy meal. Another delegate said she clapped so hard during the speech that she lost feeling in her hands. Microbloggers compared such comments to North Korean agitprop.

Communist Party leaders are well aware they must provide more than theatre to the public. They have responded to an era of unprecedented public discourse with measures more sophisticated than censoring microblogs, blocking search terms and monitoring users' accounts (all of which Chinese internet companies must do). Party leaders now seek to "guide" the public conversation with commentary that sounds more in tune with public discontent, and less like government propaganda.

The online activities of *People's Daily* and its affiliates offer some clues to the sophistication and complexity of steering public opinion. The newspaper's microblog account has published plenty of critical postings since its launch on July 22nd. On September 14th the party's two most senior propaganda officials, Li Changchun (just retired at the 18th congress) and Liu Yunshan (just promoted), visited the newspaper and its microblog operation to encourage more participation by "mainstream voices" online.

It may help that editors keep themselves well-informed on what microbloggers are discussing. *People's Daily Online*, an affiliate of the newspaper, monitors online postings and publishes a weekly journal called *Online Public Sentiment*, available for an annual subscription of 3,800 yuan ($610). Like many "internal reference" news organs within the party, the journal is available only to officials above a certain rank. As the party congress opened on November 8th, Zhu Huaxin, managing editor of the journal, published an essay in *China Reform*, a magazine, in which he called attention to growing discontent among broad swathes of society. Mr Zhu, formerly a journalist for *People's Daily*, urged the party to go further in acknowledging its shortcomings.

Everyone within the party knows the problems of social change, he wrote. Yet on official occasions media still report only good news. "Ordinary people like us all know the emperor is not wearing any clothes. The emperor himself knows that he is naked. He also knows that we know. And yet he still walked out like this." ■

China's new first lady

The voice behind the throne

BEIJING

China's first lady is better known in her homeland than her husband

AS HE settled into his new role as China's leader in the 1950s, Mao Zedong thought carefully about how his wife, an actress of some renown named Jiang Qing, would play her part in the new China. Traditional attitudes ranked stage performers just above prostitutes in China's social hierarchy and so Mao set about destroying evidence of her past career. Prints of her films were burned, and a new image for Madame Mao was created.

Taking charge of Mao's party this week, Xi Jinping is also accompanied by a wife in show business. She is Peng Liyuan, a folk singer, who holds the rank of major-general in the musical troupe of China's army. Modern attitudes are more showbiz-friendly and Ms Peng, who is about to turn 50, is anyway much too well known and far better respected to have her past erased. Indeed, for most of their 25-year marriage (Mr Xi's second) she has been much more famous then her husband. (When Mr Xi joined the standing committee of the Politburo in 2007, the joke was "Who is Xi Jinping? He's Peng Liyuan's husband.") They have a daughter, who attends Harvard under a pseudonym.

As Mr Xi has been groomed for the top job, however, Ms Peng's public profile has dimmed somewhat. If recent history is any guide, she can be expected to remain in the shadows. Since Mao's day, Chinese leaders have tried to keep their wives out of the public spotlight.

But Ms Peng may still add some pizzazz to the role. She already works to promote awareness of AIDS and other diseases in China, and last year took up a similar role with the World Health Organisation. It is unclear, though, how much attention she will be allowed to seek. Mr Xi and China's other leaders all appear to be graduates of the strait-laced technocratic school of Chinese politics. It does not seem likely that Ms Peng will be allowed to shine like Jackie Kennedy, Michelle Obama or even, heaven forbid, Raisa Gorbachev.

The very model of a modern major-general

The Economist

SPECIAL REPORT

FRANCE

November 17th 2012

So much to do, so little time


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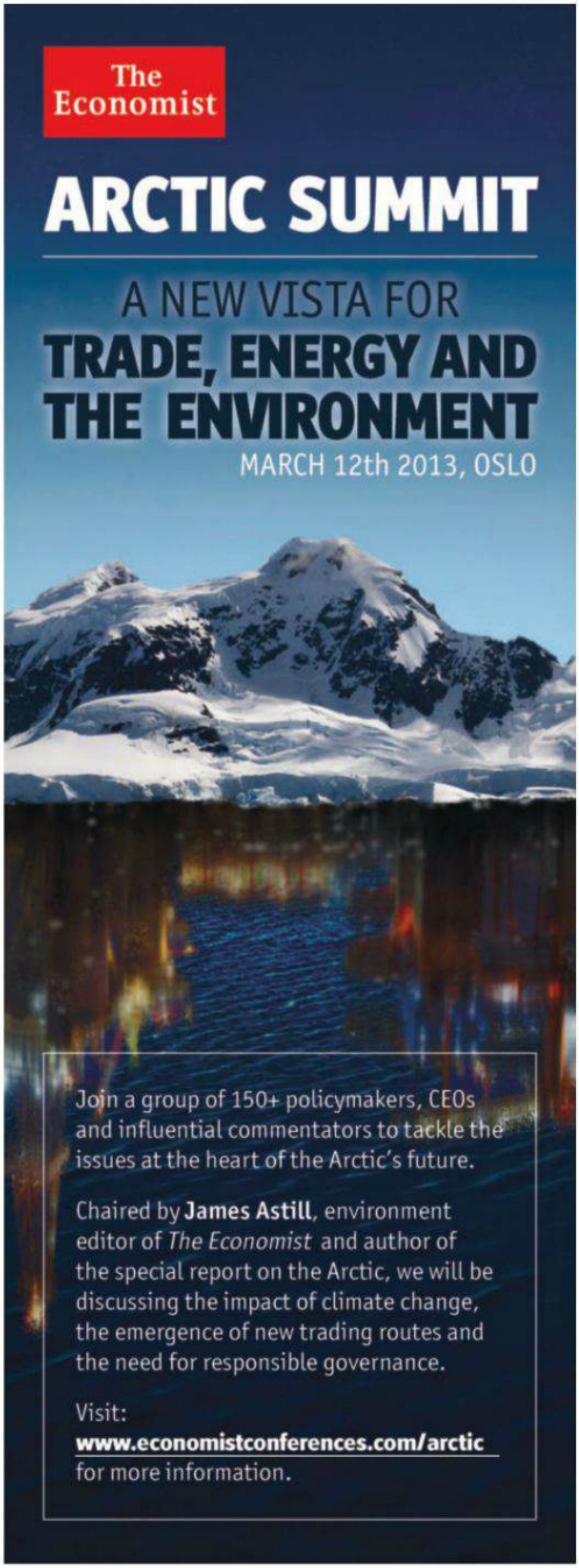
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So much to do, so little time

France is slowly heading towards a crisis, says John Peet. Can the country be reformed before it is too late?

THE HALL OF mirrors in the palace of Versailles, near Paris, where the eponymous peace treaty was signed in 1919, has been sparklingly restored. Yet as you follow the hordes of (mostly Chinese) tourists around, you notice that the reflections in the ancient looking-glasses are slightly distorted. Versailles's creator, Louis XIV, who famously asserted that "*l'Etat, c'est moi*", stood for a certain kind of statism that survives to this day, and similarly distorts the image of modern France. There are free-market successes but also too many instances of excessive state control; economic triumphs but also failures; northern puritanism but also a certain southern laxity. These contrasts make it easy to present the country in both a negative and a positive light.

Start with the negative. Public spending accounts for almost 57% of national output, the public debt stands at over 90% of GDP (and rising) and the country seems to be running a near-permanent budget deficit. It is no surprise that in January France lost its AAA grade from Standard & Poor's, a rating agency. Wealth, profits and high incomes are heavily taxed, the rich are routinely abused and people are instinctively hostile to capitalism. Everything from the labour market to pharmacies to taxis is heavily regulated: no wonder would-be entrepreneurs feel discouraged. No entirely new company has entered the CAC-40 stockmarket index since it started in 1987; redundancies can lead to endless court proceedings; and trade unions and protesters tend to take to the streets at the first hint of reform. It adds up to a deeply anti-business culture.

Yet there is also a much more positive side to the country. It is the world's fifth-biggest economy and sixth-biggest exporter. In the first half of 2012 it was the fourth-biggest recipient of foreign direct investment. It has more big multinational companies in the global *Fortune* 500 than Britain. The French are especially strong in top-end goods and services: luxury goods, food processing, pharmaceuticals, fashion. The infrastructure, especially in transport and energy, is second to none. Although ▸▸

ACKNOWLEDGMENTS

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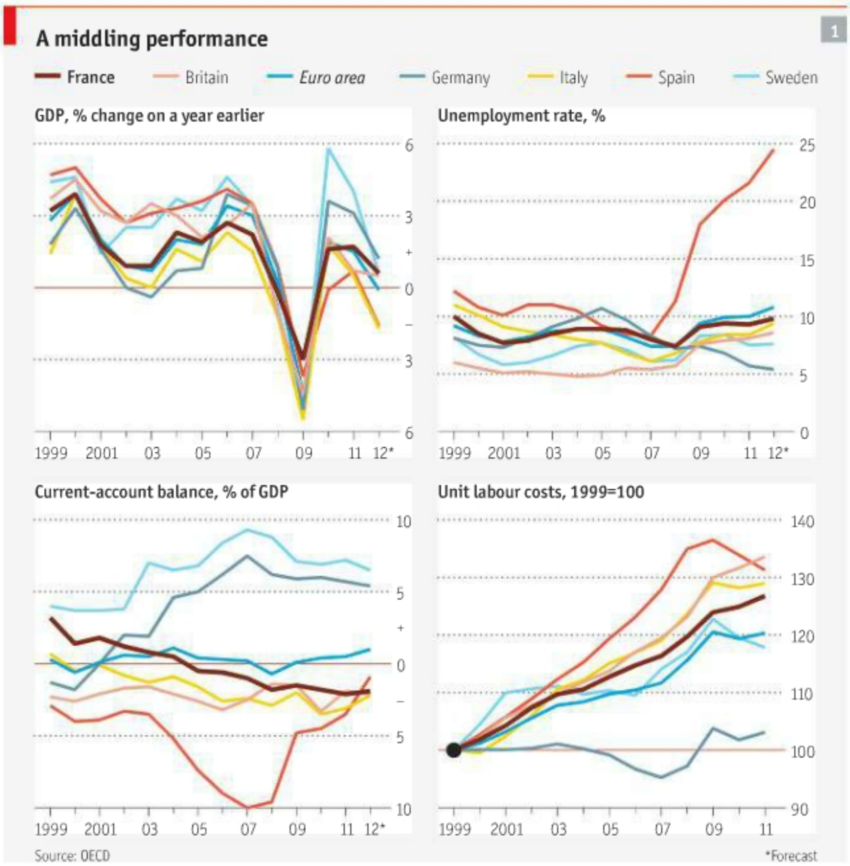


many universities are mediocre, the *grandes écoles*, such as the Polytechnique and the HEC business school, are world class. The health system is widely admired. And unlike most other European countries France has a relatively favourable demographic outlook, with a birth rate just above replacement level.

The two images are clearly both sides of the same coin. Most French people enjoy high living standards. Over the past year the financial markets have been kind to France, even after the election of a Socialist president and government, allowing it to borrow at exceptionally low rates. Yet growth has stalled and the economy is on the brink of recession for the second time in five years (see chart 1). Several big companies are planning to follow Peugeot's example by closing factories. Unemployment has recently risen above 3m, a rate of over 10%. Youth unemployment is closer to 25%, and much higher still in the *banlieues* around Paris and other big cities where ethnic minorities are mainly concentrated.

As its public-spending numbers suggest, France is also more attached to a big role for the state than any other European country. The notion that governments must steer the economy has deep historical roots, going back at least as far as the state-financed Canal du Midi under Louis XIV. His finance minister, Jean-Baptiste Colbert, founded the Saint Gobain mirror factory and took over the Gobelins tapestry firm. In the 18th century the state established the royal saltworks at Arc-et-Senans in the Doubs. High tariff barriers buttressed the policy of *dirigisme*. After 1945 France again turned atavistically to the state to draw up five-year plans for the economy.

France's position as the world's leading tourist destination is no accident, and not just because of the scenery or the food. To many people it stands for a dream, encompassing the revolutionary ideals of liberty, equality and fraternity and epitomising the taming of uncontrolled markets, the promotion of culture, literature and intellectual debate, even the very notion of civilisation. Such riches can easily lead to an unattractive arrogance, but they explain much of the country's enduring appeal. They are also among the reasons why France and the French are so resistant to change: why would you want to take the reformer's knife to a country that represents the peak of civilisation?

Certainly France has been more reluctant and slower than any other country in Europe to reform its labour-market, pension, social-security and welfare systems. It largely skipped the radical shake-ups that happened in the Netherlands, Scandinavia and Britain during the 1980s and 1990s and in Germany in the 2000s. And, as the IMF recently pointed out, it is now being left behind by reformers in Italy, Spain, Greece and Portugal.

One consequence is a pronounced erosion of competitiveness. When Europe's single currency came into being in 1999, French labour costs were below German ones and the country had a current-account surplus. Now its labour costs are far above Germany's and it has a large and rising current-account deficit.

All this has meant a grim inheritance for François Hollande, who was elected French president in May. Mr Hollande is only the second Socialist Party candidate to win the presidency since the start of France's Fifth Republic in 1958. His victory over the centre-right incumbent, Nicolas Sarkozy, came 31 years after François Mitterrand's in 1981. Mitterrand was re-elected in 1988, but during his 14-year presidency his party twice lost its majority in parliament. The Socialists' most recent stint in government was in 1997-2002, when Lionel Jospin served as prime minister in "cohabitation" with Jacques Chirac, Mr Sarkozy's predecessor.

Hollande's mandate

At least in theory, Mr Hollande is now more powerful than Mitterrand, and indeed than any Fifth Republic president since Charles de Gaulle. His party controls both parliamentary chambers and most of France's regions, departments and municipalities. The main centre-right opposition is fighting a bitter internal leadership campaign.

After the Socialists won the National Assembly election in June, Mr Hollande appointed Jean-Marc Ayrault, previously mayor of Nantes, as his prime minister. Both men lack ministerial experience, and indeed business experience, as do most members of their team. This may be one reason why they have run into so much criticism from French business for raising taxes.

Mr Hollande's victory was narrower than most opinion polls had predicted, and he owed it in large part to voters' dissatisfaction with Mr Sarkozy. As it happens, over the past two years most incumbent euro-zone governments have been turfed out by their electorates. But Mr Sarkozy also lost the voters' respect by making his a "bling-bling" presidency, starting with a flashy celebration party and an ostentatious yacht trip and continuing

with a divorce from his wife of ten years and marriage to Carla Bruni, a singer and former model. In contrast, Mr Hollande campaigned under the reassuring label of "Mr Normal".

The trouble is that the times are not at all normal. During this year's two election campaigns, for the presidency and for parliament, both main parties largely ignored the dire condition of the French economy and the euro crisis, instead offering attacks on bankers, empty talk of greater social protection, a controversy over *halal* meat and the usual ragbag of promises. Mr Hollande has honoured as many of these as he can, including cuts in ministers' pay, a partial rollback of Mr Sarkozy's increase in the retirement age from 60 to 62 and the imposition of new taxes on companies and the rich, including a 75% top tax rate on incomes above €1m ($1.3m).

Liberal commentators fretted that Mr Hollande had not grasped the nature and extent of the crisis facing France, still less understood the urgent need for reforms

Yet Mr Hollande's approval rating has plunged even faster than Mr Sarkozy's did in 2007, to below 50%. In one recent poll, almost two-thirds of respondents said they were "discontented" with Mr Hollande's actions since his election. The mood of ordinary French people is, indeed, startlingly bleak. But then the French are born pessimists. In one poll in 2011 four-fifths of the German respondents were positive about the future whereas four-fifths of the French ones were negative. Another poll found that no other Europeans were as pessimistic as the French.

Liberal commentators, including this newspaper, fretted from the outset that Mr Hollande and his team had not grasped the nature and extent of the crisis facing France, still less understood the case for reforms that the economy so urgently needs. Some even drew parallels with the new Mitterrand government in 1981, which embarked on widespread nationalisations, a public-spending spree and an attempt to soak the rich through higher taxes. Back then the franc tumbled, and only two years later the Socialist government reversed course under the influence of Jacques Delors as finance minister.

Mr Hollande is no Mitterrand. Indeed, his first experience in politics was working with Mr Delors. Like him, he is on the right of the party, in many ways more of a European Social Democrat than a Socialist. He and Mr Ayrault (who speaks fluent German) are also fascinated by Germany's recent success. In Paris there is talk about the example of Gerhard Schröder, a Social Democratic German chancellor who in 2003 introduced a package of far-reaching reforms, including measures to liberalise the German labour market. But sceptics note that he waited until his second term to push through these reforms, and that he promptly lost the subsequent election.

It is widely held in France that in office the left often turns out to be more reformist than the right. In truth all parties in France are essentially statist in outlook, and true liberals are rare. Yet when Mr Jospin was prime minister, it was evident that a leftist government was capable of privatising and liberalising more than its centre-right predecessor, at least once it had brought in the symbolically important 35-hour working week. Certainly the left ought to be better at getting the unions to accept change.

Mr Hollande has begun to talk about French competitiveness, though he gave a lukewarm reception to the recent Gallois report on the subject. Despite his campaign calls for less austerity and his (swiftly broken) promise to renegotiate the European fiscal compact, he has repeatedly insisted that he will stick to his target of cutting the budget deficit for 2013 to 3% of GDP and aiming to reach balance in 2017. The budget in late September included just about enough tax increases and (more modest) spending cuts to satisfy the markets.

The biggest concern is not that Mr Hollande will repeat the Mitterrand government's extravagant follies of 1981. Nor is it any longer, as in May, that he refuses to admit that France is in economic difficulty. It is that on this occasion there is so little time for him to act. In 1981 the economy was growing, the budget deficit was small, the national debt stood at just 22% of GDP and France still had its own currency. Today the economy is at a standstill, the deficit is above the 3% ceiling, the debt is over 90% of GDP and France is in the euro zone. The euro crisis keeps going, and although France is still able to borrow at low cost, market sentiment can switch suddenly.

A favourite saying of Mitterrand's was that "*il faut donner du temps au temps*" (time must be given time to do its work). Mr Hollande has spoken of two years to pursue reforms. He may find he does not have even that long. ■

The economy

Doing so-so

But how to regain competitiveness?

SINCE THE EURO began life in 1999, the French economy has performed neither brilliantly nor disastrously but somewhere in between. It has certainly not done as well in recent years as Finland, Germany or (outside the euro) Sweden. But it has not sunk as far as Italy and Spain, let alone Greece, Ireland and Portugal. And it suffered far less in the 2008-09 financial crisis than Britain did. Within the euro zone, the country with perhaps the closest economic record to France's is the Netherlands, which has also lost competitiveness against Germany—but the Dutch still have a large current-account surplus.

In fact the French economy has been deteriorating for many years and this has simply become more obvious since the arrival of the euro, which precludes the tempting cure of devaluation. Ever since the end of the *trente glorieuses*, the 30 highly successful years after the second world war, France has come to rely heavily on public spending for growth. As Michel Pébereau, a banker, put it in a 2005 report on the public finances, "each time a new problem has arisen in the past 25 years, our country has responded with more spending." The budget has not been balanced in any single year since 1974.

Not all public spending is wasted. But it is striking that 15 years ago public spending as a proportion of GDP was at similar levels in France and Germany and much higher in Sweden, whereas now France's public spending, at almost 57% of GDP, is more than five points above Sweden's and almost ten points above Germany's (see chart 2, next page). It is not obvious that French citizens reap commensurate extra benefits. France has 90 civil servants for every 1,000 inhabitants (compared with just 50 in Germany), which adds up to a huge 22% of the workforce, far

above the European average. The only country to rival France's profligacy recently has been Britain, and there the state takes only just over 50% of GDP and the government is sharply cutting spending. It is hard not to conclude that the size of the French public sector has become a deadweight dragging down growth.

France also has a chronic unemployment problem. Only once in the past 20 years has the rate fallen below 8%; it is now over 10% and rising. Because of high social charges, burdensome labour-market regulation and the difficulty and cost of making workers redundant, big and small companies alike have been reluctant to create new jobs. The French like to boast of their high productivity, but this reflects not just efficiency but also an unwillingness to hire. In many French factories workers are notably thin on the ground. The Paris metro has begun to operate driverless trains, ostensibly to improve security and reliability but presumably also to save on costly and strike-prone labour. Even French vineyards are investing in expensive machines to replace human grape-pickers.

Still more worrying is the inexorable decline in the competitiveness of French industry, which has had a direct bearing on growth. The European Commission says that between 2005 and 2010 France's share of world exports shrank by almost 20%, a decline exceeded within the euro zone only by Greece. France's current account has deteriorated significantly. A decade ago it was in surplus; now it is showing the biggest deficit (in cash terms) of any euro-zone country. All the indicators show a marked loss of competitiveness, especially against Germany. France has dropped to 29th in the World Bank's "Doing Business" scorecard, and to 21st in the World Economic Forum's competitiveness rankings (badly trailing Germany, in 6th place, and Britain, 8th).

Mr Hollande and his new government initially seemed oblivious to all this, partly because France's borrowing costs have actually fallen since he came to power (and the bond spread over Germany has narrowed). The early measures that he pushed through a special session of parliament in July either did nothing to deal with the country's economic problems or actively made them worse. The partial rollback of the pension reform, cutting the retirement age from 62 to 60 for some workers, sent the wrong signal to the rest of the euro zone. So did the reversal of a measure introduced by Mr Sarkozy transferring some payroll charges to a new social value-added tax, which has the advantage of being charged on imports and consumption but not on exports and employment.

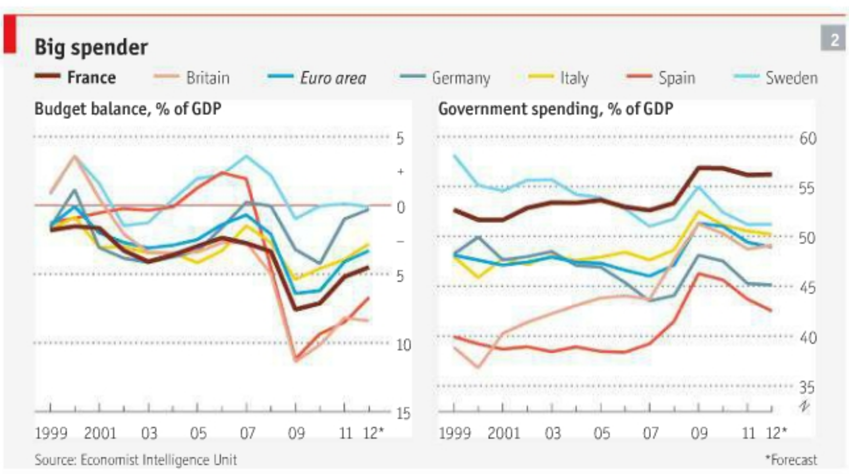
Perhaps worst of all was the new president's decision to impose a new top rate of income tax of 75% on annual incomes above €1m. The government has admitted that this will raise little money. Recently Mr Hollande has backed off a bit, calling it a temporary measure for two years only. Nicolas Baverez, an economist who often writes about French decline, describes the new rate as "absurd"; and Erik Izraelewicz, editor of *Le Monde*, a newspaper generally sympathetic to the left, calls it "purely political: it is Hollande's 35-hour week". When France's richest man, Bernard Arnault, announced in September that he was applying for Belgian citizenship, many blamed the proposed 75% rate (though Mr Arnault, who also left the country in 1981 when the Mitterrand government came in, insists that he will still pay his share of French taxes).

Gallant Gallois

By September ministers seemed to have woken up to the need for more radical action. Laurence Parisot, the boss of Medef, the main employers' federation, notes that in July Mr Hollande gave an unusually emollient speech at a conference of employers and unions, but his prime minister, Mr Ayrault, went back to business-bashing rhetoric. The Medef delegation refused to applaud. A chastened Mr Ayrault came to the organisation's summer school in late August and talked instead about recognising the challenges of business. The government also asked Louis Gallois, a businessman, to report on ways of improving competitiveness. Although it rejected his demand for a "competitiveness shock", it has promised to cut taxes on labour.

Pierre Moscovici, the finance minister, talks up the pressing need for labour-market reform to boost employment, stresses the importance of fiscal discipline and acknowledges the need to improve French competitiveness. As for the 75% tax rate, he insists that it is appropriate to get the rich to pay a bit more. He favours naming and shaming those who seem to be trying to avoid their fair share of taxes.

Mr Moscovici also suggests that public spending will decline over time, perhaps to 53% of GDP. In the government's first budget in late September two-thirds of the fiscal adjustment was to come from tax increases (roughly €10 billion on companies and €10 billion on individuals) and only one-third (another €10 billion) from spending cuts. But for 2013 and beyond Mr Moscovici is thinking of a 50-50 split. The effort needed will be considerable: in July the Cour des Comptes, the national auditor, put the gap for 2013 at €33 billion, and a lower growth forecast has made it even bigger. Mr Baverez is not alone in being sceptical that such a large adjustment will be possible, pointing out that the package is proportionately twice as big as the one that helped bring down Mr Chirac's first government.



The budget was greeted with some street protests but also with considerable anger by many French businessmen. Their gripe was not the 75% tax rate but big increases in taxes on corporate profits, capital gains, dividend payments and wealth. Many claimed that such tax hikes would simply drive entrepreneurs abroad. After a campaign by *les pigeons*, an entrepreneurial protest movement, the government has reduced its planned hike in capital-gain taxes.

It also claims to be serious about labour-market reform. Michel Sapin, the labour and social-affairs minister, was briefly finance minister under Mitterrand and understands what needs to be done. He notes that only one young worker in five can now expect to move from a tem-

One out, all out

porary to a permanent contract, meaning that older "insiders" are being protected at the expense of younger "outsiders". He points to youth unemployment of up to 25% as a consequence. And he notes that, thanks to generous retirement terms and high social charges, France has an unusually low labour-force participation rate for 55- to 64-year-olds. All this, he concedes, impairs France's international competitiveness.

The government wants to negotiate with the unions and employers to make the labour market more flexible (Mr Hollande prefers the less neo-liberal "supple"). Mr Sapin is bringing in more subsidised job contracts, such as exempting older workers from social-security contributions if their employers also take on younger people on permanent contracts. He hopes to reduce payroll charges. The new labour-market rules, he says, would be good for both employers and workers. Yet they would still leave France with a more regulated market than many other countries in Europe, including Germany. And for all that, Mr Sapin may still find it hard to persuade the trade unions to accept the broad need for change.

Despite their reputation for militancy, the unions are fairly weak in France, with one of the lowest penetration rates in Europe. The second-biggest union, the CFDT, seems eager to reach an agreement with the government. Laurent Berger, its incoming leader, sees a trade-off between more flexibility for employers and more security for younger workers. He is willing to accept more part-time contracts and curbs on the freedom of sacked workers to sue in the courts, though at a price. Ms Parisot of Medef sees this as a crucial reform, noting that if changing circumstances force a firm to reduce its workforce, the risk of ending up in court represents not just a huge cost but a strong deterrent to hiring in the first place.

Mr Sapin insists that if there is no agreement the government will legislate anyway. Mr Hollande has brought forward the deadline to the end of this year. Yet even Mr Berger thinks it unlikely that all the unions will accept new labour laws by then. More probably his union will agree but the bigger and more militant CGT and the smaller Force Ouvrière will not. The stage may then be set for a wave of strikes next year against both labour-law reform and the government's public-spending cuts. ■

Business

A lack of enterprise

France needs more start-ups and Mittelstand firms

AULNAY-SOUS-BOIS SOUNDS LIKE an idyllic rural spot, but in reality it consists mostly of ugly industrial estates clustered to the north of Paris, hard by Charles de Gaulle airport. It has been in the news of late because it is the site of a car factory that the owner, PSA Peugeot Citroën, plans to shut down. Earlier this year Mr Hollande described this plan as "unacceptable" and promised that it would not be allowed to go through. In the past Arnaud Montebourg, whom he appointed as minister for productive recovery within the finance ministry, has talked of banning what he calls "stockmarket-driven" redundancies, and even of expropriating companies that close factories.

Yet Peugeot has now confirmed that big losses and continuing overcapacity in the car industry are forcing it to close Aulnay-sous-Bois after all. It has offered the workers new jobs at another of its factories, in Poissy, to the west of Paris, the nearest of Peugeot's five remaining ones. But most of the disgruntled men leaving work after the morning shift do not want to move. Philippe Julien, the local CGT representative, says his union would much prefer to divide the existing workload among all six factories. He and his colleagues feel let down by the Hollande government, for which most of them voted. In a play on the French for liar, they talk of Mr Menteurbourg. They are hoping for support from other workers, in the form of street protests and perhaps strikes.

Peugeot is not alone: Renault is also suffering from excess capacity. As if to demonstrate France's competitiveness problem, this comes at a time when Volkswagen and other German carmakers are expanding. Even Britain, widely derided in France as a country that has almost completely deindustrialised, now has more car factories than France. Other French companies that are laying off workers, despite Mr Montebourg's strictures, include ArcelorMittal, which is closing two of its blast furnaces at Florange in northern Lorraine, Air France, Bouygues Telecom, Doux, Hersant Media, Sanofi and SFR.

France still has plenty of successful, world-class multinationals in a wide variety of industries. They include such well-known names as Michelin (tyres), Pernod Ricard (drinks), LVMH (luxury goods), Carrefour (supermarkets), AXA (insurance) and L'Oréal (cosmetics), as well as two of the biggest banks in Europe, BNP Paribas and Société Générale. But lists such as these also reveal some problematic characteristics of corporate France.

One is that most French companies have been around for a long time. A second is that their profit margins have become much thinner. Gross operating profits for non-financial firms have fallen by six points over the past decade. In 2011 margins for companies outside the CAC-40 were at the lowest level for 25 years, whereas in Germany margins have been rising. A third is that many of the best French firms make most of their money abroad. That may explain why in the three years to 2010 the members of the CAC-40 increased their global employment by 5% but reduced employment in France by 4%.

Even so, many companies still succeed against the odds. ▸▸

Consider Valeo, one of the world's biggest car-parts companies. Jacques Aschenbroich, its chief executive, notes that his is a global industry, although competition is at its most intense at regional level. For Valeo that means Germany, which has gained an edge over France in the past ten years. Unsurprisingly Mr Aschenbroich says one of the biggest problems for companies in France are vertiginous social charges (see chart 3). The labour market is still too rigid, and he complains about the 35-hour week brought in by the Jospin government, not because he is against shorter hours in principle but because it replaced a 39-hour week without pay cuts to match. Yet he welcomes the R&D tax credit brought in by Mr Sarkozy and is optimistic about the chances for Mr Hollande's labour-market reforms.

Another company boss, Clara Gaymard, who runs the operations of America's General Electric in France, is also hopeful about labour-market reform. She describes Michel Sapin, the labour minister, as a good listener who approaches the issue without preconceptions. The need is pressing: as she points out, the present rules create legal obstacles that make it all but impossible to restructure a company. But GE has not given up in France, where it makes medical devices, turbines and aero engines.

> ***Manufacturing in France has fallen to only 11%of GDP, about the same as in Britain and far less than in Germany or Italy***

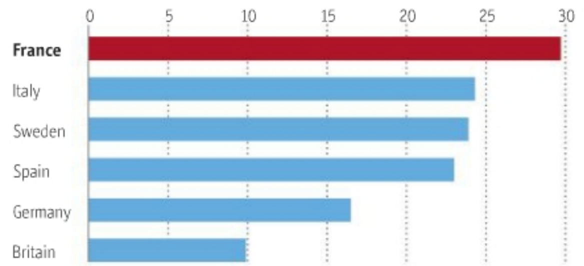
Corporate France is strikingly short of two things. One is new companies, especially in high-tech and internet businesses. There are some, such as Free, a subsidiary of Iliad, a company that has established a grip on broadband services in France, much to the annoyance of the telecoms incumbents; or vente-privée, an internet retailer run by Jacques-Antoine Granjon. Yet Mr Granjon is gloomy about the future. He says the French system stifles entrepreneurs. He blames governments of right and left alike for disapproving of profits and wealth, for making clear their dislike of the rich, for favouring consumption over investment, for imposing excessive taxes on businesses and individuals and for pushing public spending too high. He is also scathing about France's educational system. His own three children are being taught abroad, as is common among French bosses.

If that is what French entrepreneurs think, it is little wonder that their country has proved bad at growing and cultivating new high-tech businesses. But, to be fair, the rest of Europe is little better when compared with America, apart from Scandinavia and a few other northern parts of the continent.

It is the second gap in corporate France that is both more striking and more worrying: the absence of mid-sized companies like Germany's *Mittelstand* firms, which form the backbone of the German economy. According to one estimate, France has just over 4,000 medium-sized enterprises, proportionately only half as many as Germany and Britain. And the average French company, with just 14 employees, is a lot smaller than the average German one, which has 41. (This point, along with others in this section, is made by Sophie Pedder, *The Economist*'s Paris correspondent, in her recent book, "Le Deni Français".)

Unaffordable 3

Employer social-security contributions, % of labour costs, 2011



Source: OECD

Keeping small businesses down

One reason is that expansion of a business is vigorously discouraged by rules and taxes. Researchers at the London School of Economics found that France has a strikingly large number of companies with 49 employees. That is because many of the regulations governing companies kick in when a firm gets to 50. According to a 2008 official commission on growth chaired by Jacques Attali, once an adviser to Mitterrand, no fewer than 34 laws and regulations start to apply once an enterprise reaches that number.

Successive governments have tried to simplify the system, but generally without much success. The creation by Mr Sarkozy's government of *pôles d'emploi*, modelled on British job-centres that had impressed his then finance minister, Christine Lagarde, has made it easier to combine drawing benefits with looking for work. Ms Lagarde, who is now managing director of the IMF, was also behind the creation of a system of "auto-entrepreneurs" under which individuals can register a business with a minimum of fuss and formality.

Mr Montebourg thinks these helpful gestures by previous governments are insufficient. Well to the left of his party and with a book attacking globalisation to his name, he challenges the assumption that further deindustrialisation is inevitable. Although he failed to stop Peugeot closing Aulnay-sous-Bois, he insists that "there is no industry that we have to give up." He claims to appeal to patriotism, not nationalism or protectionism, and harks back to models such as Franklin Roosevelt's National Industrial Recovery Act of 1933 and the Tennessee Valley Authority. He calls bankers "parasites" and hopes to use the government's new public investment bank to help save French manufacturing.

Yet this seems a lost cause. Manufacturing in France has fallen to only 11% of GDP, about the same as in Britain and far less than in Germany or Italy. As governments of every stripe in many different countries have found, politicians who set out to pick winners often end up subsidising losers instead. The future ought to lie with services and smaller companies, to which the government pays rather less attention.

It would also be a good idea to encourage finance, even though the government has such a low opinion of banks. On the whole the French banks are in reasonable shape. None of the big ones has had to be bailed out by the state, although Société Générale has occasionally looked wobbly. Dexia, a Franco-Belgian bank, collapsed in 2011, and this year the Hollande government had to rescue a small mortgage lender, Crédit Immobilier de France (CIF).

Even so, the euro crisis and the downturn have not left the banks unscathed. French banks were among the most exposed to Mediterranean sovereign debt when the crisis broke. They have quietly reduced their exposure, but they are still potentially vulnerable on this score. And any fall in property prices could easily take down other mortgage lenders besides CIF. ■

The provinces

Deep roots

From deep rurality to multi-ethnic suburbs, non-metropolitan France matters

THERE IS SO much more to France than Paris. Cities like Bordeaux, Lille, Lyon, Nice and Toulouse count for a lot, both economically and politically. The country's variety is entrancing, one reason why so many foreigners come to France and so relatively few French people holiday abroad. France boasts some of the world's most beautiful Gothic cathedrals, such as Amiens, Chartres, Notre-Dame de Paris and Reims, as well as some of its finest medieval sculptures in Autun and Vézelay. There are Flemish towns like Lille and Arras, Italianate ones such as Nice and Menton and Teutonic cities like Strasbourg and Metz. And along with Loire valley chateaux such as the fairytale Chambord and the river-crossing Chenonceaux there are the gorgeous multicoloured roofs of Beaune and Dijon, spectacular hilltop villages along the Côte d'Azur and in the Cathar country of the Languedoc—and some of Europe's most modern and fashionable ski resorts.

The political significance of regional France is enhanced by the tradition of multiple mandates, which has meant that many ministers and deputies in Paris have simultaneously been presidents or mayors of local regions, departments or towns. The effect of this lingers even though the Hollande government is trying to put a stop to the habit, at least for ministers. Nor is France as rigidly centralised as many believe. Until the late 19th century most of the population in the south, for example, spoke variants of Occitan rather than French. Now, thanks to successive waves of decentralisation, regional and local government accounts for a fifth of public spending.

The weight of what is sometimes known as *la France profonde* is greater even than this number suggests. Geographically, France is western Europe's biggest country (even if you leave out the French overseas departments), and much of it has remained well hidden until surprisingly recently. Even today there are not many more visitors to the Massif Central than in the days when Robert Louis Stevenson was travelling with his donkey through the Cévennes in 1878. The Gorges du Verdon, Europe's very own grand canyon, did not feature at all on maps of France until it was rediscovered at the end of the 19th century.

Farming also matters far more in France than in many other countries. The population became urbanised relatively late: even in 1920 over a third of French people lived in rural areas, a far bigger share than in most of the rest of Europe. The cult of the *paysan* remains: many of today's Parisian sophisticates can trace their ancestral roots to the countryside, and plenty still keep a property in the country—something that came in useful during and just after the second world war, when food was scarce. Even today the French fervently believe in the magical qualities of their local vineyard or of the *terroir*.

Politically, agriculture also packs a big punch. Would-be presidents have to spend long hours stroking cattle at agricultural fairs. France is always the stoutest defender in Brussels of the European Union's extravagant common agricultural policy, the biggest beneficiaries of which are not indigent peasants but the grain barons in the Paris basin. Hostility to CAP reform is unlikely to change under a Socialist government, even though France has now become a net contributor to the policy as subsidies are shifting eastwards.

Popes and presidents

Corrèze is as remote an example of *la France profonde* as you can find. Its capital, Tulle, has few hotels. The tourist office is not busy, although Tulle has a fine cathedral as well as France's last accordion factory. The multi-storey car park is free. Yet this region of France has nurtured not only three popes in its time, but two of the country's three most recent presidents, Jacques Chirac ▸▸

and François Hollande. The joke in Paris has it that French politicians hail either from Corrèze or from abroad (a play on Mr Sarkozy's Hungarian origins and on the fact that many of them were born in the Maghreb).

The importance of Corrèze to both presidents is hard to overstate. Mr Chirac started his political life as a minister of agriculture. As president he fought tooth and nail against CAP reform. He also ensured that his remote department got lots of goodies from the central government. Two largely deserted motorways run through it. The mayor of Tulle, Bernard Combes, is pressing for a high-speed rail line to connect Paris, Orléans, Limoges, Brive (near Tulle) and Toulouse.

Mr Chirac's strangest legacy is his own museum, set amid herds of Limousin cattle in the tiny village of Sarran, close to his small country chateau. It contains the usual memorabilia and a library, but at its heart are the 5,000 gifts that he received during his 12 years as French president. The result resembles nothing so much as a junk shop: vulgar T-shirts and flags are displayed in cases alongside hideous plates, a stuffed coelacanth, cowboy boots and vast quantities of other tat. Even the old Citroën in which Mr Chirac paraded to celebrate his election as president in 1995 is on show.

The museum is notable for another reason: its cost overruns and its annual losses. Corrèze has the dubious distinction of being the most indebted region of France. Many people blame Mr Hollande, who was successively mayor of Tulle and then president of the regional council at a time when spending grew fast and bureaucracy mushroomed. His successor as council president, Gérard Bonnet, insists that most of the debt was incurred by Mr Hollande's centre-right predecessors. He points the finger at the Chirac museum, which cost over €10m to build and, thanks to a scarcity of visitors, manages to lose €1m a year.

Mr Bonnet also says that Paris has devolved many powers to local government without passing on the accompanying cash. (Critics in Paris retort that local-government spending has gone up faster than central-government spending, pointing out that employment in local government has risen by almost 50% over 12 years, whereas central-government staffing has remained broadly unchanged.)

Mr Hollande did more than just run up debts and hire too many public servants in Corrèze. He put down political roots. For many years he made the five-hour drive from Paris to Tulle every weekend to cheer up his supporters. Since he was elected president he has already visited the town four times. Locals are

Not so many more in the sea

Losing its sparkle

Paris is not what it was

PARIS DOMINATES FRANCE, politically and economically. Some argue that in an essentially conservative country it inspired France's revolutionary fervour over several centuries, from 1789 to 1968. Indeed, it was fear of the city's political influence that led France to deny Paris a mayor of its own from 1794 to 1977 (except for brief interludes in 1848 and 1870). When the office was eventually reinstated, its first occupant, Jacques Chirac, nursed his presidential ambitions from the Hôtel de Ville.

Paris can claim to be one of the world's most beautiful cities, with such gems as the Louvre, Sacré Coeur and the museums of Rodin and Picasso. For most of the 19th and 20th centuries it was the cultural capital of Europe. Yet just as the French economy is wilting under competitive pressure, so too is Paris. One example is finance, in which it used to be a world leader. The first overseas office of an American investment bank, Morgan Stanley, opened in Paris in 1967, ten years before it went to London. But since then Paris has not only lost out to London as a financial centre, but dropped out of the top ten and now trails behind even Geneva and Zurich.

It is a similar story in gastronomy, where some Spanish and Scandinavian cities as well as London now boast better restaurants. Much of the art market has moved to London, New York, Hong Kong and Singapore, driven out by high taxes. In fashion and design, cities like Milan now rival the French capital. For modern art, music and theatre, Berlin has a buzz that Paris largely lacks. For weekend breaks, youngsters from around Europe prefer Barcelona, Prague or Tallinn to the high prices and poor service of Paris. As for the famous Champs-Elysées, the supposedly Elysian fields are now a by-word for scruffy cafés and souvenir shops.

What has gone wrong? One answer is that Paris, like France as a whole, prefers a culture of preservation to one of innovation. Cranes and new high-rise buildings are a perpetual feature of London, but are rare in Paris. Young people and immigrants, always a source of inventiveness and creativity, can no longer afford to live in or anywhere near the city's centre. The transport system is impressive, but traffic jams are often worse than in London (Paris has no congestion charge), and lobbying by incumbents has left Paris with proportionately half as many taxis as London or New York. The main airport, Charles de Gaulle, has four runways to London Heathrow's two, but its terminals are cramped and badly laid out and transport links to the city are poor.

Paris suffered a big blow when, having started as the favourite, it lost its bid for the 2012 Olympic games to London. Retiring hurt, it did not try for 2020 but is thinking of having a go for 2024, the centenary of the "Chariots of Fire" games it hosted in 1924. Like France itself, the city needs to rediscover the dynamism and creativity that once made it a world-beater.

obviously fond of him: Mr Combes, the mayor, once worked for him and praises his "normality" and accessibility. Yet there have been few takers for a tourist trail that includes Mr Hollande's favourite café, La Calèche, and the local party office where he would sleep on Saturday nights. Perhaps Tulle is just too remote.

Adieu, la Marseillaise

Nobody could say that of Marseille, France's third-largest city and biggest port. Yet Marseille has had a terrible press in recent months. After a spate of more than 40 drug-related murders over the past two years it is being likened unflatteringly to Rio de Janeiro. The mayor of the worst-affected districts of Marseille caused a stir in August by calling for the army to be sent in. Mr Hollande's government has responded by appointing a new police chief, the fourth in two years, and by dispatching the prime minister to visit the city.

Locals complain that this is all terribly unfair. Yves Moraine, a lawyer and leader on the council of the centre-right UMP party, says the murders are about account-settling among drug dealers. In other respects the city is doing fairly well. Average unemployment, at one time over 20%, is now down to 12%. And ordinary crime levels, he insists, have gone down, not up. At the town hall officials point to the inward investment that is coming to Marseille. The city has embarked on one of Europe's biggest urban-renewal projects, including a complete revamp of the old port, in time for its stint as European Capital of Culture in 2013.

In many ways Marseille is an appealing place. As a Mediterranean port it has always been both international and ethnically mixed. Its racial minorities, unlike those in Paris and Lyon, often live close to the city centre, not in run-down *banlieues*. Wandering in the neighbourhood markets near to the old city and around the railway station, you could easily imagine yourself shopping in the souks of Marrakesh or Tangier.

Marseille does have big problems, not least of widespread poverty. On a walk around its poor 15th district there are few people, cars or policemen to be seen, perhaps because they feel unsafe as the evening draws in. A shop with a sign claiming that it is open day and night is firmly closed. The local branch of Médecins du Monde is thronged with patients who have no other access to medical services. Several Roma gypsies have recently been arrested here and deported to Romania, but they usually find their way back. Youth unemployment in this part of Marseille runs at up to 50%. Gilbert Collard, a far-right deputy in the National Assembly born in the city, argues that part of the reason for its drug culture and recent turf wars is the near-total breakdown of social and family ties in the most deprived districts.

In the past racial tensions were often high in Marseille and even more in its neighbouring region. When the *pieds noirs*, French settlers in Algeria, returned home in the 1960s, many of them went to live in Marseille. For a long time the nearby town of Vitrolles was a stronghold of Jean-Marie Le Pen's ultra-right National Front. Public opinion has often been against new mosques.

Yet on the whole relations with ethnic minorities seem better in Marseille than in the north of France, which is now the region with the strongest support for the National Front. Riots and car-burnings in the suburbs of Paris, and most recently in Amiens, have shown the extent of racial disharmony there. Car-burnings still run at thousands a year but no longer draw much public comment. Ethnic minorities and immigrants in France suffer disproportionately from high unemployment and crime and are underrepresented in public life. Failure to build mosques is not trouble-free, either: at one point thousands of Muslims were closing roads in Marseille and north-eastern Paris to hold Friday prayers in the open.

The government has long refused to collect figures on ethnic origin, maintaining that all the country's inhabitants are French. Yet France has by far the biggest Muslim population of any country in the European Union: some 5m-6m out of a total of 65m (it also has the biggest Jewish population in the EU). In the long-running arguments about assimilation versus multiculturalism, secular France has always stood firmly for the first. It was one of the first EU countries to ban women from wearing the all-covering Muslim veil in public—though wags maintain that among female French Muslims there are far more bikini-wearers than burqa-wearers. ■

Foreign policy

Away and at home

Disagreements with Germany over Europe could spell big trouble

RATHER LIKE BRITAIN, France has inherited the mindset of a world power with neither the reach nor the means of one. De Gaulle only partly succeeded in his life's ambition of restoring his country's lost glory. His intransigence ensured that France would be seen as a victor in the second world war and thus a rightful aspirant to a permanent seat on the United Nations Security Council. But his decisions as president in the 1960s to leave NATO's military-command structure and to keep an independent nuclear deterrent at any price did little to help France's global pretensions.

Even so, a mid-sized power with special links across Africa is not insignificant. Under the energetic Mr Sarkozy, France played a global role when it held the EU's rotating presidency in 2008 during Russia's invasion of Georgia, and then again in 2011 when it was president of the G8 and G20 during some of the darker moments of the financial crisis. In 2011 France and Britain also led the military intervention in Libya.

The French have gone into several African countries on their own and played a decidedly inglorious role in Rwanda in the 1990s. They are mulling some kind of intervention in Mali.

Yet recent talk by Mr Hollande of taking action in Syria is unlikely to go anywhere, partly because there is little enthusiasm for it, but also because defence cuts have undermined France's military capacity. The future must lie in more defence co-operation with Britain, the only other European country with global aspirations.

At least France retains a pivotal role in the European Union. A founder member of the then European Economic Community, it will in January celebrate the 50th anniversary of the Elysée treaty with former West Germany that established the Franco-German relationship as the driver of the project. You only have to visit the ossuary at the 1916 battlefield of Verdun, site of a famous handholding between Helmut Kohl and François Mitterrand in 1984, to see the importance to Europe of Franco-German reconciliation. Even if the French have not always controlled the Brussels machinery on their own, they have been much better than the Germans at bagging big jobs: president of the European Commission (twice), the commission's secretary-general (for almost 30 years), and successive chief legal advisers at the Council of Ministers. They have also fiercely insisted, against much opposition, on keeping the European Parliament in Strasbourg.

Yet France and the French have always been ambivalent about Europe. De Gaulle himself was never comfortable with the EEC. He managed not only to keep Britain out but also to secure an effective French veto under the 1966 Luxembourg compromise. The Maastricht treaty that paved the way for the single currency was largely the brainchild of Mitterrand, whose price for accepting German unification was Germany's abandonment of the D-mark in favour of a single currency over which France hoped to have more control. But when he put the treaty to a referendum of his countrymen in September 1992, it was approved by only a wafer-thin majority.

More dramatic still was the 2005 referendum on the draft constitutional treaty for the EU, drawn up by a convention chaired by a former president, Valéry Giscard d'Estaing. The result was a resounding "no", after a campaign in which French voters for the first time debated the EU's laws and practices—and took a dislike to an organisation that seemed far too keen on free movement of labour from poorer countries to the east, on free-market liberalism in general and on the supposed benefits of greater competition. Rather like the British, the French have never warmed to the idea of ceding sovereignty to Brussels.

Not French enough

Many French politicians believe that the EU has changed from a project that was designed partly in France's interests—for example, getting German taxpayers to pay a large chunk of subsidies to French farmers—into one that frequently acts against them. They are painfully aware that France has less influence in an EU of 27 countries than it did in one of six, nine or 15, whereas a unified Germany has a lot more. Even the French language, once dominant in the corridors of Brussels, has lost out to English. To some in Paris this is symptomatic of the triumph of Anglo-Saxon liberalism inside the European institutions. France led the opposition to the notorious (in Paris) "Bolkestein" directive that tried unsuccessfully to free up EU trade in services (and enrich the continent).

This is not a left-right issue. Bruno Le Maire, a conservative who was Mr Sarkozy's agriculture minister, attacks the EU for being too concerned to protect consumers instead of producers and jobs. He cites EU rules that prevent schools in Normandy from buying locally grown but more expensive apples for their meals. He denounces the EU as more liberal even than the United States. And he says he would like to rebuild a (presumably rather less open) new grouping around the euro zone of 17, not the current EU of 27. He might find himself in surprising agreement with Arnaud Montebourg, the left-leaning minister for productive recovery. Mr Montebourg believes that EU laws and regulations inhibit the sort of proactive industrial policy he favours. He accuses the EU of the "Talmudic application of rules designed 50 years ago". Although the French left has traditionally been more pro-European than the French right, that is by no means true across the spectrum.

This sharpens the dilemmas facing Mr Hollande over the EU and the euro crisis. The 2005 referendum was undoubtedly Mr Hollande's most traumatic political experience. As first secretary of the Socialist Party he was strongly in favour of the constitutional treaty, but many in his party ignored him and it split down the middle, with Laurent Fabius, a former prime minister, leading the "no" campaign. As it happens, Mr Hollande has chosen to make Mr Fabius his foreign minister. His Europe minister, Bernard Cazeneuve, also voted no in 2005.

Mr Hollande himself is instinctively pro-European, far more so than Mr Sarkozy—and it is the Elysée that largely sets France's policy on Europe. Yet he and his officials know that, thanks to the euro crisis, the Franco-German relationship has become hugely unbalanced in Germany's favour. It is Angela Merkel, the German chancellor, who calls the tune in negotiations over the future of the single currency, and thus of the EU more broadly. And her cures for the euro crisis—ever greater fiscal austerity, more structural reforms to promote competition, faster moves towards political and economic union—are not naturally

The Merkozy show

A dispute between the Germans and the French over moves towards political union could turn into a huge obstacle to resolving the euro crisis

welcomed in Paris.

So Mr Hollande is scrabbling to strengthen his position relative to Germany. Charles Grant of the London-based Centre for European Reform believes that he is trying to achieve that in three ways. One is to forge stronger links with Mediterranean countries, especially Italy and Spain, to form a block that could help to counter Mrs Merkel. Naturally that has upset her. Mr Sarkozy preferred to stick closely to Mrs Merkel (hence the label "Merkozy"), not least to identify France with the north and keep the markets happy. Mr Hollande likes to straddle both sides: as his Europe minister puts it, France is the hyphen in Europe's north-south division.

Second, Mr Hollande wants to meet the targets set in the European fiscal-compact treaty, which the French parliament has just ratified. And third, he is aiming to raise the French economy's performance by improving its competitiveness. But it will take long and hard toil for France to regain its economic and financial clout when measured against Germany.

Then there is the tricky issue of closer political union. As the euro crisis drags interminably on, many political leaders have concluded that the only alternative to a break-up is closer economic and fiscal integration. The Germans believe that the mistake was that the economic and political union promised at Maastricht was never completed, leaving a single currency with neither common fiscal rules nor a proper system of economic governance. As one German official puts it, "if they want our taxpayers' money, we have to control how it is used." So if the euro is to be saved through a banking union, common bank deposit insurance or, eventually, some form of debt mutualisation, in exchange the Germans want a commitment now to a deeper political union, including a new EU treaty.

Non, Angela

Mr Hollande's new government is looking for a different timetable and a different sequence of events. The buzzphrase in Paris is not political union but *intégration solidaire*. This starts from the assertion that France has made a huge sacrifice of sovereignty by accepting the budgetary austerity inherent in the fiscal compact. The next steps ought to be, first, to put fresh emphasis on growth instead of on austerity alone; and then to ensure that the European Central Bank stands fully behind euro-zone governments' sovereign debt. There should also be more rapid moves towards a banking union and the issuing of eurobonds. Only after this "solidarity" is in place might it be right to debate deeper political integration.

Yet that debate, though still largely taboo in Paris, has already begun in Berlin and Brussels. A group led by the German foreign minister, Guido Westerwelle, has proposed majority voting in foreign policy, a European army, an elected European Commission president and more powers for the European Parliament. José Manuel Barroso, the current commission president, has called for a fuller "federation of nation-states". Such talk is airily dismissed in France, where it is said that, whenever Europe is going through a crisis, the Germans and the commission start talking about political union without really meaning it.

However, this time may be different. A dispute between the Germans and the French over moves towards political union could turn into a huge obstacle to resolving the euro crisis. In effect, the Germans are saying they will not lend their credit card to other euro members without a prior commitment to much tougher controls and deeper political integration. The French insist the euro zone needs Germany's credit card now, and they are not ready to discuss more integration until later. These opposing positions could cause a serious impasse. Logic suggests the Germans will prevail, but French obstructiveness could be costly. ■

Politics

The mixture as before?

Much of French politics is not a matter of left and right

ONE REASON WHY French political leaders are so reluctant to cede more power to Brussels is that, under the constitution of de Gaulle's Fifth Republic, they have such a lot of it. In most European countries coalition governments are the norm, so elected parliaments are robustly independent. In France, save for the occasional periods of cohabitation, the president is all-powerful, able to pick and choose prime ministers and members of the government at will and largely unchallenged by any parliamentary opposition. Presidential authority also benefits from France's relatively weak and often fawning media.

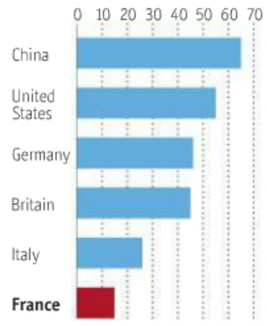
This has several undesirable consequences. One is that opposition in France, rather than making itself heard in parliamentary or public debates, often takes the form of street demonstrations. Mr Chirac's first government was confronted by rampant protests in 1995, and managed to lose a snap parliamentary election two years later. Mr Sarkozy's early attempts at reform a decade later also provoked big demonstrations.

French politics in the Fifth Republic is also unusually personalised. Political parties have a tendency to become vehicles for their leaders. Indeed, the centre-right UMP has often changed its name when it has acquired a new leader. This is not true of the Socialists, but the system of primaries to choose the party's presidential candidate has weakened the grip of its left-bank grandees. In 2007 Ségolène Royal was backed by few of the party's bigwigs yet won the presidential nomination before losing the election to Mr Sarkozy.

The French system also tends to produce political leaders who are all of a type. Few have any business or international experience or speak any foreign languages. Most are graduates of one of the *grandes écoles* (Mr Sarkozy was an exception, but with Mr Hollande the country has resumed its habit of choosing *énarques* as presidents). Most ministers, even on the lower pay set by ▸▸

Not our thing 4

"Capitalism is a system that works well and should be preserved"
% agreeing*



Source: Ifop *Poll conducted December 2010

Mr Hollande, work in grand town houses dotted around central Paris and are ferried about in cars (you seldom see a minister on the metro). All this breeds a detachment from reality that strengthens an innate belief in statism, a mistrust of free markets and a hostility to the world of finance and commerce, all deeply entrenched in the French body politic.

Filthy rich

Indeed, such views are entrenched in the minds of many French voters as well. In this respect France is different from many other affluent countries. One businesswoman says that the rich are now stigmatised in the way Jews were 70 years ago. Perhaps as a legacy from the revolution, the French are also obsessed by inequality—even though France is now a rarity in that inequality, as measured by the Gini coefficient, is actually lower today than it was in the mid-1980s.

Similarly, economics textbooks in schools and universities generally take a more hostile view of free markets and a more favourable one of state intervention than those in other countries. Opinion polls show that the French are less keen on Anglo-American free markets than people in other countries. Asked if capitalism is functioning reasonably well and should be preserved, only 15% of respondents in France say yes, compared with 45% in Britain, 55% in America and 65% in supposedly communist China (see chart 4). This is partly hypocrisy: despite its apparent distaste for American imports, France has more McDonald's restaurants than any other big country in Europe, and American-style coffee shops have made inroads into the market of traditional French cafés.

This is not a matter of left and right. Mr Hollande once said he did not like the rich, and in the election campaign declared that the chief enemy of France was finance. So far, so expected; but he was echoing not only Mitterrand (who denounced "all the power of money") but also de Gaulle, who declared that "my only enemy, and that of France, has never ceased to be money," and Edouard Balladur, a former Gaullist prime minister who once defined civilisation as the struggle against the market. No French political leader would dare to emulate Peter Mandelson, a senior British Labour politician, who said in 1998 that he was "intensely relaxed about people getting filthy rich".

One possible exception may have been Mr Sarkozy. In 2007 he defeated Ms Royal by running as an outsider, a man with a Hungarian father and who did not graduate from a *grande école*. He also told voters that France needed to change, to learn from other countries such as Britain and America and to be prepared for what he called *la rupture*. For a time before and after his election in May 2007 he seemed to be the man who might at last reform France. He faced down strikes to eliminate special pension regimes for some public-sector workers, shook up and partly liberalised the universities and began the long process of pushing up the retirement age.

It was the onset of the financial crisis in 2008 that drove Mr Sarkozy off course, in two ways. The first was economic: slower growth and then recession, followed by rising public borrowing and debt and higher unemployment, would have made reform harder to implement. The second was to undermine many of the arguments he had used for change. It was difficult to preach the case for freer markets when free-market excesses were widely thought to have caused the global financial meltdown. Mr Sarkozy himself was never a natural liberal. One fellow political leader from the European People's Party, the club of centre-right parties in Europe, recalls that when he and his colleagues discussed such goals as lower taxes, a smaller state, freer markets and deregulation, Mr Sarkozy would often argue against them.

The all-but-total absence of a liberal voice is another striking feature of French politics. Philippe Manière, a commentator, laments that "nobody in France campaigns for liberal ideas now." A few years ago Alain Madelin, a centrist politician, made a stab at it, and a new liberal think-tank is soon to be launched. But although France's first dictionary of liberalism has just come out, liberal-minded thinkers and political activists find it hard to get airtime, win seats or spread their ideas.

The future of the right in France is equally unclear. It is impossible to say which of the two candidates for the leadership of the centre-right UMP will win the primary that is now under way. According to most opinion polls the favourite is François Fillon, who served as prime minister throughout Mr Sarkozy's

What would Mitterrand have done?

presidency. But his rival, Jean-François Copé, has been running the party for the past two years, and only members of the UMP can vote.

The first test for whoever wins may not be how best to oppose Mr Hollande's government but how best to deal with the far right. Ten years ago the world was shocked when the National Front's Jean-Marie Le Pen pushed the Socialists' Lionel Jospin out of the presidential run-off, thereby handing the second round to Mr Chirac. The National Front is now led by Mr Le Pen's daughter, Marine, who took 18% of the vote in the first round of this year's presidential election. She did not get into the run-off, but the combined score for her and the far-left candidate, Jean-Luc Mélenchon, both standing on an anti-euro, anti-EU and anti-free trade platform, was a shocking 30%. The National Front also won seats in parliament this year for the first time since the 1990s.

Mr Hollande is having to deal with tensions between his former partner and his current girlfriend, Valérie Trierweiler

Ms Le Pen's strategy is clear. She is trying to broaden the National Front's appeal by toning down its attacks on immigration and diluting its racist and often anti-Semitic message. In their place she has put hostility to Islamification, and also to the EU and the euro, which she blames for aggravating rather than helping to solve France's economic crisis. In a grumpy country that feels increasingly marginalised in Brussels, this plays well. To vote for or work with the National Front is no longer seen as socially beyond the pale, which is why more women now do so.

Left in charge

For now, however, it is the Socialists who are firmly in power, and the most pressing question for France is whether they are capable of restoring the economy to health. Even neutral observers doubt both Mr Hollande's belief in reform and his strength of resolve to push it through.

Alain Minc, a well-connected analyst who is sympathetic to the centre-right, concedes that Mr Hollande is clever and well-informed, but notes that the president and his team have no knowledge or experience of any kind of business. Mr Minc finds it telling that the government advocates the policies of John Maynard Keynes (to boost domestic demand) but not Joseph Schumpeter (for the creative destruction that goes with entrepreneurialism). It may not be 1981 all over again, he adds, but the Hollande government is still essentially suspicious of business.

That view is shared by Maurice Lévy, the boss of Publicis, a public-relations giant. He agrees that Mr Hollande is intelligent, citing as an example a meeting with him last December at which he conceded not only that steep social charges were putting French business at a competitive disadvantage but also that the Socialists' hallowed 35-hour week had been a big handicap. Yet he faults the president for not grappling with the crisis and instead running through his campaign "shopping list": raising the minimum wage, cutting the price of petrol, bringing in the 75% tax rate and so on. Mr Lévy suggests that a leader who wants to reform France needs two things: a real sense of crisis, and balls—and implies that Mr Hollande lacks both.

There are other reasons for doubt. When Mr Sarkozy tried to restart the reforms that Mr Chirac largely abandoned, he had one big advantage: that he had won a mandate by campaigning for change. Zaki Laïdi, a professor at Sciences-Po and a supporter of Mr Hollande's, insists he is a convinced reformer, though he admits reform is hard in a country without a culture of compromise. But most voters thought the Hollande message was not so much about reform as about ending unnecessary austerity, one reason why there were protests against September's belt-tightening budget.

Sotto voce, supporters of Mr Hollande voice doubts about his grit and determination for another reason that has echoes of his predecessor: difficulties in his romantic life. Mr Sarkozy was distracted early in his presidency by the very public departure of his then wife, Cécilia, and by his courtship of and marriage to Carla Bruni. Mr Hollande, who is unmarried, is having to deal with tensions between his former partner (and mother of his four children), Ms Royal, and his current girlfriend, Valérie Trierweiler. Ms Trierweiler, a journalist at *Paris-Match*, lent public support to a political rival of Ms Royal's who went on to defeat her in the parliamentary election in June (Ms Trierweiler later apologised). Ms Royal had hoped to become speaker of the National Assembly and is still casting about for some political role. If Mr Hollande cannot cope at home, some ask, can he really cope with the problems of his country? ■

The future

Look about you

If other European countries have recently managed big reforms, why can't France?

THIS SPECIAL REPORT has argued that the economic problems facing France are grave and immediate and that the need for reform is pressing. None of this was much talked about in the presidential and parliamentary election campaigns earlier this year. Yet the new government of François Hollande has belatedly come to recognise some of the dangers.

Some seasoned politicians seem to believe that reforming France is impossible. That is too pessimistic. Many other European countries that for years resisted change have now pushed through substantial, politically controversial and often painful reforms. But almost all have four things in common that are currently lacking in France: a deep and widespread sense of crisis; a population that accepts there is no alternative to change; a political class with the fortitude (and often also an electoral mandate) to push it through; and leaders who really believe in what they ▸▸

are doing rather than feel it is being forced on them from outside.

Examples abound. In the 1980s the British, Dutch and Irish went through painful adjustments. Over the past decade the three Baltic countries, especially Latvia, have undergone what economists call an "internal devaluation" in which wages and GDP per head have shrunk by a quarter or more in order to regain lost competitiveness. Since the euro crisis began in earnest in late 2009, Greece, Ireland and Portugal have imposed swingeing budget and wage cuts and other unpopular reforms on their voters. Spain and Italy are having to do the same.

The northern route

The two best models for France are Germany and Sweden. Germany, inside the euro, became so alarmed by slow growth, lack of competitiveness and high unemployment in the euro's early years that the Social Democratic chancellor at the time, Gerhard Schröder, brought in a series of reforms to improve labour-market flexibility and make welfare payments somewhat less lavish. This was the basis for today's super-competitive economy. An even better example is Sweden, outside the euro, which began its reforms after a banking crisis in the early 1990s. Under a centre-right government since 2006 it has stuck firmly to continuing fiscal retrenchment and reform of labour markets and the welfare state. Sweden is now growing and creating jobs, and has even administered a fiscal stimulus.

These examples show what can be done, but they also demonstrate that reform is difficult and painful. The first Socialist president to be elected in France in almost a quarter of a century will find it especially hard. Mr Hollande knows what happened to Mr Schröder: the voters kicked him out in 2005. And he is familiar with the aphorism cited by Jean-Claude Juncker, the prime minister of Luxembourg and president of the euro group of finance ministers, that "we all know what needs to be done, we just don't know how to be re-elected after we've done it."

The French people may be waking up to their troubles, but there is nothing like the sense of crisis felt in the Baltic countries, in Athens, Dublin and Lisbon, and now in Madrid and Rome. Moreover, neither Mr Hollande nor Mr Ayrault seems to be the sort of leader who will be resolute in a confrontation. If and when things go wrong Mr Hollande might be forced, like so many of his predecessors, to find a new, tougher prime minister, perhaps Manuel Valls, the interior minister, or Michel Sapin, the labour minister. But that would happen only if the pressure for change were to become far more intense.

Things in France may thus need to get a lot worse before they get better. The reforms and austerity being pursued by other euro-zone countries are reducing their cost base and shrinking their current-account deficits, leaving France much more exposed. Differences between France and Germany over deeper political and economic integration are adding new tensions.

It is widely believed that Spain and Italy are the key tests for whether the euro will survive, but in some ways France may be more crucial still. If it does not improve its competitiveness and also obstructs deeper integration, it is hard to see it staying in the euro—and it is almost impossible to envisage a single currency without it. Precisely when all this comes to a head may depend on events in the run-up to the German election next September, on whether new turbulence hits the euro—and, above all, on how long financial markets continue to treat a largely unreformed France as a safe haven for their money.

A crisis is surely coming. Yet when it arrives, reforms in France may not have to be quite as savage or as impossible to push through as many believe. France has some big advantages, and the French are capable of accepting change. Not long ago it was thought they would never accept a smoking ban in indoor public spaces, or observe speed limits. Now they meekly do both. Many of them rail against globalisation, yet they eagerly embrace its fruits. They may believe that free-market capitalism is bad, but they are suprisingly adept at practising it.

A bold and determined reformer could restore French competitiveness, boost growth and reduce unemployment, restoring some of the former glory. The trouble is that, on the evidence so far, it is hard to see the normal, easygoing Mr Hollande as the man to do it. ■

Getting from non to oui

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Palestine, Israel and the UN

Nerves are jangling again

JERUSALEM AND RAMALLAH

Will Israeli and Palestinian leaders let a renewal of violence in Gaza get out of control and make diplomacy even harder to revive?

A SUDDEN frightening surge in violence in Gaza and adjacent bits of Israel, along with the prospect of Israel's humiliation at the hands of the Palestinians at the UN, is threatening to upset the calm that Binyamin Netanyahu, Israel's prime minister, had hoped to vaunt in the run-up to Israel's general election on January 22nd. If Mahmoud Abbas, the Palestinian leader who runs the West Bank, the main chunk of a would-be Palestinian state, keeps his promise to go ahead and win enhanced observer status at the UN General Assembly on November 29th, Mr Netanyahu's government may be tempted to take punitive measures that might even lead to Mr Abbas's downfall. And if the latest bout of violence between Israel and the Palestinians in Gaza, which is ruled by the Islamists of Hamas, gets out of hand, Egypt's Islamist government could threaten to scrap the peace treaty with Israel. As turmoil rattles the wider region, none of this is likely to benefit anyone but warmongers.

The temperature rose earlier this month when a rocket fired from Gaza, probably by a Palestinian group that is a lot wilder than Hamas, which has generally abided by an informal ceasefire since 2009, hit an Israeli jeep across the border, wounding four soldiers. A retaliatory Israeli air raid killed four Palestinians at a funeral. More Palestinian rockets were fired, some by Hamas itself. Then, on November 14th, Ahmad Jabari, Hamas's military commander, was killed in an Israeli air strike, prompting a still more vigorous Hamas response. The next day, in an even more dangerous escalation, a rocket killed three Israeli civilians in a town between Gaza and Tel Aviv, Israel's biggest city.

Though hundreds of rockets have been fired at Israel from Gaza in the past year, most of them have been inaccurate homemade contraptions; not a single Israeli had previously been killed by one this year (and about a score since 2004), so the latest Israeli fatalities may prompt Mr Netanyahu to retaliate more fiercely still. As *The Economist* went to press, there were the usual futile worldwide calls for restraint.

So the atmosphere at the UN, in the run-up to the Palestinian vote, is likely to be even steamier. Israeli ministers have been threatening to pull the financial plug on the Palestinian Authority (PA), the body that all sides agreed upon in 1994 to manage Palestinian affairs, if Mr Abbas wins an enhanced status (though not full membership) for Palestine at the UN. But Palestinian leaders say that, if Mr Abbas backs off at the last minute as he did before, the PA will collapse for lack of political progress, albeit of a symbolic kind. He sorely needs a moral and diplomatic victory. "No longer will Palestine be an occupied territory, but an occupied state," says Muhammad al-Shtayyeh, a confidant of the PA president.

For his part, Mr Netanyahu worries that, if the Palestinian bid succeeds, rivals at home will accuse him of losing his diplomatic touch as well as letting violence in Gaza spiral. Israel has already surrendered its long-standing friendship with Turkey, the sole big Muslim country with which it has amiable relations. Barack Obama, back in the White House, is a lot less warm to him than the losing candidate, Mitt Romney, would have been. With Islamists gaining ground in a hostile neighbourhood and many countries once against chastising Israel over Gaza, Israel may start to feel lonelier again. Mr Netanyahu, who seemed electorally impregnable, may suddenly look vulnerable.

Israel's finance minister, Yuval Steinitz, has threatened—if the UN bid goes ahead—not just to stop transferring the tax revenues that make up almost half the PA budget but to stop collecting them altogether. Yet Israeli army commanders shudder at the chaos that might ensue if the PA's 50,000 security people were unable to put food on the table. Indeed, Israel has been so worried by the PA's budget crisis that in the past three months it has advanced $200m to the PA and issued Palestinians in the West Bank with several thousand more permits to work in Israel. "It's in Israel's interest to preserve the PA," says an officer, examining various contingencies.

Not all Israelis agree. Avigdor Lieberman, who leads a far-right party in the ruling coalition as Mr Netanyahu's foreign minister, has repeatedly called for the PA to be dissolved. Since Mr Liebermann's party agreed last month to fight the election in an alliance with Mr Netanyahu's Likud party, his voice may carry more weight than before. Other hawkish Israelis, reverting to the old slogan of "Jordan is Palestine", have hailed influential Jordanians who recently declared that the notion of a two-state solution (Israel and Palestine existing side by side in peace) is dead, and ▸▸

that Jordan should take what is left of the West Bank back under its control.

Mr Abbas needs whatever scraps of political credit he can get. The vitriol that Israelis have heaped on him as he heralds his UN bid has helped shore him up a bit, only days after he was denounced as a traitor by many of his fellow Palestinians for appearing on Israeli television to cede the supposedly sacred right of Palestinian refugees to return to their old homes within the internationally recognised borders of Israel, in his case the Galilee town of Safed.

Mr Abbas also badly needs international support to help him re-establish his authority over the Palestinian territories, including Gaza. Visits to that beleaguered coastal strip by the moneyed emir of Qatar, by Bahraini princes and Egyptian ministers have all bolstered the claim of Gaza—and of Hamas—to be Palestine's new centre of gravity. Hamas may also be reviving its ambitions in the West Bank. PA and Israeli officials both say it is rebuilding its base there, five years after it was clobbered for taking over Gaza.

That, perhaps, is another reason for Mr Netanyahu to want to cut Hamas down to size over the rockets. But by boosting sympathy for the recalcitrant Islamists, he may also be doing down the most peace-minded of Palestinians, Mr Abbas. ■

Libya

Rising from the ruins

MISRATA

Amid lingering violence, a modern state is struggling to take shape

A CLUTCH of archaeologists sits in a freshly upholstered auditorium near the Roman amphitheatre in Leptis Magna to learn how to use a global positioning system, something restricted to the security forces under Colonel Muammar Qaddafi. "Take a picture, then note the co-ordinates," says an instructor, showing slides of the ruins (pictured above).

The country and the government apparatus left behind by the erratic dictator, who had run the show for 42 years, were almost as decrepit as these relics of Rome. To ensure that not the slightest whiff of dissent could exist, institutions and even state bodies were never allowed to grow. Political parties were banned. Yet since the colonel's death in October last year at the hands of rebel fighters, Libya has not only held national elections, followed a fortnight ago by the presentation of a diverse government, albeit that not all of its members have been endorsed. It has also started to build a new system of civil administration that may one day form the backbone of a law-abiding and prosperous society.

Fears—especially in the West—that extreme Islamists are spoiling Libya's chances of creating a peaceful democracy grew in September, after the American ambassador and three fellow American diplomats were killed in an attack on the American consulate in Benghazi, Libya's second city. In the heat of the American presidential election, Barack Obama was blamed for allegedly letting al-Qaeda back into the Libyan arena.

But on the ground, the picture, though far from uniformly rosy, is more hopeful. Many of the new state structures and services, including archaeological conservation in Leptis Magna, are being created from the bottom up rather than handed down by a central government that is still only embryonic. The new powers in the land are council leaders, a sort of cross between mayors and regional governors. Some are doing well. Most took part in the rebellion, often as administrators rather than fighters. Salim Betamal in Misrata and Abdulalli Abu Saif in Brega were academics who, as the rebellion erupted, co-ordinated civilian dissent. Ali Thow Labaz in Sirte was an oil executive who became a strategist for the rebels. Masoud Ahmida in Ajdabiah was a dentist who then managed a field hospital.

Each in his own way is trying to make up for decades of neglect during which Qaddafi concentrated resources in Tripoli, the capital. "The farther you move away from Tripoli," says a Western diplomat, "the less of a state you see." But that is changing. Regional structures are taking shape. Rickety they may be, but they increasingly trump those in the capital, where political rivalries and the fear of being accused of corruption have led ministers to duck hard decisions. Some cities are creating their own economic links with the outside world. Misratans now have a range of daily flights to neighbouring countries.

Dynamic local leaders have improved services. The streets of a range of coastal towns are far cleaner than in Cairo or Tunis. Rubbish-collecting lorries and street sweepers in tidy overalls are out every morning. Hospitals have reopened. Most important for ordinary Libyans, services such as tap water and electricity—disrupted during the rebellion—are working just about everywhere. Children are back at school. In Brega and Sirte, where campuses were badly damaged, student and teacher numbers are down but universities in both towns have recently reopened. "The money to rebuild came from the central government," says Mousa Muhammad Mousa, the new head of Sirte's university; the city, he implies, is not being punished for its sympathy for Qaddafi.

As you travel from west to east along the coastal belt where most Libyans live, the improvements are palpable. In Misrata only the main street still shows the ravages of war, and even there new glass façades have gone up. Some 28,000 of the 40,000-odd landmines laid in Brega are said to have been removed. Only Sirte, Qaddafi's hometown, where he was caught and killed, is still a mess, with many people still living in bombed-out ruins and shacks. Dozens of new hotels are opening across the country, their lobbies filling up with dealmakers. Cafés are opening along the coastal road.

Local government must operate in a legal vacuum until a new constitution is agreed upon, probably not before the middle of next year. In the meantime local leaders owe their legitimacy to the citizens. Misrata and Benghazi held municipal elections several months ago. Ajdabiya, which lies between the two, will follow suit by ▸▸

the end of the year. The people of Brega and Ras Lanuf chose their councils and leaders at public meetings. Only Sirte, the Qaddafi stronghold, remains under a forced administration, its local leaders chosen by the authorities in Tripoli. Benghazi and Derna, in the east, are still struggling to contain discontent. Jobless young people in these towns are still liable to be recruited by extremists.

Local loyalties, sharpened during the revolution, have given rise to fears that Libya could break up. Misratans, who suffered most in the war, proudly mention their hometown in almost every breath, ridiculing people from Zintan, another rebel bastion, accusing them of stealing an elephant from the Tripoli zoo during the capital's liberation. Misratan militias recently fought a full-scale battle with rivals in Bani Walid. To ease tensions, posts in the new government have been dished out on a regional basis.

Fears of separatism may, in any case, be overblown. Family links across the sparsely populated country bind people together. Provided the country's oil wealth is distributed, it can serve as a national glue, as it did under Qaddafi. The government is already using it to buy off people with separatist tendencies—"federalists", as they call themselves, especially those from the east, who resent being dominated by Tripoli.

At the general election in July, federalist candidates were roundly defeated, but have won concessions in the aftermath. Easterners are likely to be over-represented in the constitution-writing body relative to the size of their population. The headquarters of the national oil company may even be brought back to Benghazi.

Another key to rebuilding the state is to foster reconciliation by accommodating the less nasty parts of the old regime. Ali Zidan, the new prime minister, is from Sirte, though he was a dissident rather than a loyalist. Mr Labaz, Sirte's council leader, says, "They loved Qaddafi here and people cry, as everyone does when you lose a loved one, but they will forget."

Notable figures from the old regime will be put into political quarantine for five or ten years, except for a handful who switched sides early in the revolution. The most bloodstained will be put on trial, but there is little talk of punishing people on the fringes of the old order. Civil servants and businessmen, many of whom collaborated with Qaddafi to some degree, are needed for reconstruction.

Oil production has passed its pre-war level of 1.5m barrels a day. The country's biggest refinery, in Ras Lanuf, went back on stream two months ago and is exporting fuel again. A Russian service company has been invited back, despite Russia's opposition to the revolution. But most foreign oil firms are treading water, since the authorities are loth to award new concessions until next year at the earliest. Meanwhile the government is priming the pump, cutting the domestic price of fuel by 25% and expanding the range of staples, such as cooking oil, sugar and tea, that it subsidises, along with rice and flour. This will cause trouble in the long term, but at least it shows that the state can make a difference.

Now put those guns away

The ugliest fly in the national ointment is the sporadic violence still tarnishing several of Libya's cities. Pockets of jihadist sympathisers still exist, especially on the eastern side of the country. Gratuitous or celebratory shooting is less common than it was just after the revolution but gun battles between militias, both Islamist and secular, still frequently occur. So do assassinations and car bombings, usually perpetrated by militias that fought against Qaddafi. Some have turned to crime, while trying to secure political jobs for their leaders. Others have taken up the jihadist cause. Most insist on keeping their arms for fear—they say—of a possible counter-revolution.

The government is keeping a wary eye on suspected jihadists. And it is trying to get the militias off the streets and to integrate them into a revamped police force and army. In small towns, civilians appointed by local councils are trying to impose their authority over the militias. But in Benghazi and Tripoli many remain a law unto themselves. Earlier this month some that were supposed to have been inducted into the regular forces fought a running battle in a central bit of Tripoli that lasted all day. The police simply closed the road and let them fight it out.

The prime minister is holding talks with two five-member councils representing eastern and western revolutionaries, in the hope that they will persuade their militias to join a force that will be modelled on America's National Guard and will patrol the borders. "This is the new government's top priority," says one of the negotiators. Indeed, Libya's future depends on it. In Iraq the militias, with jihadist factions among them, fatally undermined the fledgling civil administration. They must not be allowed to do the same in Libya. ■

Syria's opposition

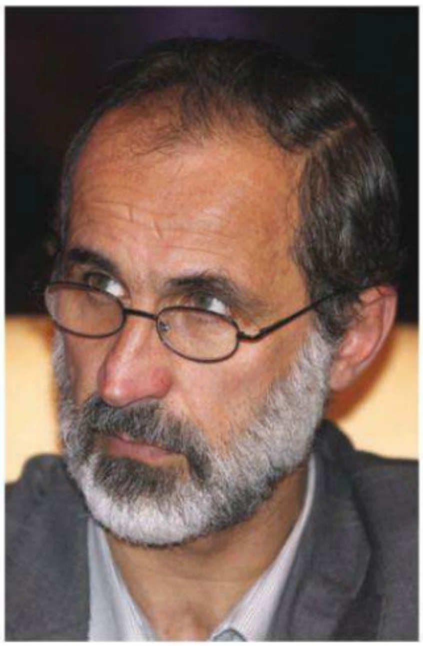
Higher hopes

BEIRUT

Can Syria's new opposition coalition make a difference?

DIPLOMATS were getting grouchy, journalists were packing up to leave and Syrians were losing faith in the ability of their political opposition ever to get their act together. But at the last minute, on November 11th, bleary-eyed opposition figures, meeting in Qatar's capital, Doha, signed a deal to meld a new opposition group to be called the Syrian National Coalition for Revolutionary and Opposition Forces. Many Syrians said they felt hopeful that a plausible alternative to Bashar Assad and his regime had at last been found.

The make-up of the new 63-member body certainly improves on the Syrian National Council (SNC), previously promoted as the opposition's main umbrella group. Now led by a Christian politician, George Sabra, the council was folded into the national coalition after being offered 22 seats. In contrast to the long-exiled men who have been leading the SNC, the new coalition is headed—for the time being—by Ahmed Moaz al-Khatib, a moderate imam from one of Syria's grandest religious and national institutions, the Umayyad Mosque in Damascus. Banned from preaching under the Assad regime, he left the country only in July. Mr Khatib has been given two impressive deputies: Riad Seif, a prominent businessman and former parliamentarian, and Suheir Atassi, a not-



Khatib eyes his chance

ed female activist, both of them former political prisoners widely respected by Syrians of all hues.

In his acceptance speech Mr Khatib set out a vision for Syria to include all of its minorities, including the Alawite community from which Mr Assad hails. Though the new coalition is short of women, it includes a clutch of Kurdish figures, members of the local co-ordination committees, and representatives from each of Syria's 14 provinces.

The six countries of the Gulf Co-operation Council, of which Saudi Arabia is the beefiest, immediately recognised the coalition as the Syrian people's sole representative. President François Hollande of France, the only Western leader to do likewise, mooted arming the rebels, something Western governments have hitherto ruled out. At the least, the coalition will immediately get aid for the rebel-administered areas, where basic services have ground to a halt and misery looms.

But the new body's impact on the war in Syria is less certain. "Its influence on the situation inside the country depends in great part on its ability to get supplies to the rebels and rebel communities," says Ammar Abdulhamid, a dissident based in Washington, DC. "If it fails in this, it loses everything." Mr Khatib has called for more than humanitarian aid to help cement his coalition's authority, but officials from warier countries, including Britain and the United States, say recognition will come only if the new lot sets up effective technical committees, proves its popularity with Syrians on the ground, and brings most of the rebel groups under its umbrella.

A tall order, perhaps. The gap between the rebels' political and military leaders has so far been almost impossible to bridge. Coalition members say setting up a military council is their priority, but no rebel commanders are yet represented on it. In any case, their efforts will be futile if the providers of weapons, especially Qatar, Libya and Saudi Arabia, decide to work outside the body. Previous attempts to create a single channel for funds and weapons have been repeatedly stymied by backers going through personal contacts, picking favourites and stirring rivalry and jealousy among the rebels.

But if the coalition proves itself, some hitherto nervous Western governments may reconsider their stance on lethal aid. After announcing that British diplomats would talk to rebel commanders but saying he had no plans to arm the rebels, David Cameron, Britain's prime minister, appears no longer to be adamant in ruling out weapons if the bloody stalemate persists. While America is still opposed to sending arms, it might find a way to help Qatar send more sophisticated weaponry.

This is looking increasingly likely, since a political solution appears as implausible as ever. Some diplomats, including the UN's envoy to Syria, Lakhdar Brahimi, see the creation of the coalition as the first step on the road to a political transition, Mr Assad's removal included. Yet the coalition's founding document expressly rejects talks with the regime. Russia, Mr Assad's main ally, which would have to accept the coalition as a credible alternative, gave it a cool welcome. In any case, Mr Assad shows no signs of leaving; he and the opposition fighters both continue to think they can triumph militarily.

For the desperate Syrians, peace cannot come too soon. As winter approaches, over 2.5m of Syria's 23m people are displaced, doctors and medicine increasingly scarce. The conflict is spilling into Kurdish areas in the north-east that were previously peaceful; on November 12th fighter jets bombed a town in that area close to the Turkish border. In the south-west, Israel hit Syrian targets for two days in a row after mortars fired from Syria landed in the Israeli-occupied Golan Heights. Amid high expectations, the new coalition has its work cut out to ensure that it does a lot better than the failed national council. ■

Syria's Palestinians

Stateless and hapless as ever

CYBER CITY, ON THE JORDAN-SYRIA BORDER

Syria's Palestinian refugees are being both thumped and cold-shouldered

HELD in a hostel for migrant workers, Palestinians who have fled Syria's civil war pass their days exchanging pictures on their mobile phones of the corpses of relations who failed to get out. "They are here till the war ends," says a sympathetic Jordanian policeman, who mans a checkpoint near the hostel to bar their way out.

Close relations in Amman need permits to visit their camp in the midst of a barren free-trade zone rather hopefully named Cyber City, near Jordan's border with Syria. Families cram into small rooms, with grey UN blankets for doors. Each inmate lives on coupons worth $30 a month that they can spend at a lone camp stall. Unlike the Syrians who stream into Jordan each night in their hundreds, no one formally recognises the Palestinians as asylum seekers. The UN shunts responsibility from one agency to the next. Yet the Palestinians who are let into Jordan are relatively lucky. The UN says three-quarters of the 500,000 Palestinian refugees who have been living in Syria have been harmed in the uprising. More than 600 of them are thought to have been killed.

Never anywhere to go

Rebels and regime forces are recruiting and arming Palestinians, dragging their camps into the fray. Some rebels have sought refuge and medical treatment in the camps, hopeful that the UN agency responsible for Palestinian welfare might offer international protection. Some later sought to use the camps as a haven to shoot at loyalist forces, who shot back. Shelling since the summer has emptied Deraa, a dismal Palestinian camp of some 23,000 near Syria's border with Jordan.

The regime has turned to Palestinian militias it has sponsored for decades. Some have eagerly responded but others, most notably the Islamist movement, Hamas, have changed sides. So the camps have become battlefields. Seeking safety in numbers, many Palestinians in Deraa fled to Damascus, only to find themselves caught in the crossfire again. Dozens have been killed in fighting in Yarmouk, a camp-cum-suburb on the edge of Damascus that is home to 80% of Syria's Palestinians. On November 12th Palestine Street, a main road to the camp, erupted in flames.

Some 10,000 have fled to Lebanon, but only 1,600 have got into Jordan. That figure is surprisingly low, since Jordan houses half of the 400,000 Syrians who have fled the carnage, and Deraa is only five minutes' drive from the border. Unlike Syrians, Palestinians need visas to enter Jordan, which for over a year, say exiles, have not been dished out. Some forge Syrian papers to slip in and hide with relatives. Palestinians caught crossing are usually sent back. "Wein Baba (Where's Daddy)?" cries a toddler, banging his fists. His father handed

himself in to Jordan's authorities but within three hours was back in Syria; soon after he was killed. "Neighbours aren't very welcoming to Palestinians," sighs a senior UN refugee-agency man, Filippo Grandi.

For decades, Jordan's monarchs did more than any state to provide a haven for Palestinians. But the influx has reduced the kingdom's indigenous Bedouin to a minority. Though they dominate the armed services, they fear that letting any more in will turn their realm into a Palestinian state. At the Cyber City checkpoint, the police have stitched "Jordan First" emblems onto the lapels of their uniforms, as if to imply that Palestinians come second.

Jordan has other reasons for fearing a spillover. Some 3,800 rebels have slipped in alongside the refugees. Jordan fears they may not only provoke Mr Assad's regime to strike back, perhaps with car-bombs, but may also raise the flag of jihad to recruit Jordanians to their cause. Last month Jordan said it had uncovered three Salafist plots, two of them orchestrated by Syrians, to bomb civilian and Western targets in the kingdom. America has sent 150-plus military advisers to Jordan, perhaps to prepare for the creation of a Syrian buffer zone across the border from Jordan.

With Jordanians this week taking to the streets across the kingdom to protest against rises in the cost of fuel, the government and the king are unusually edgy. Jordan's Muslim Brotherhood, with its ties to Hamas, is limbering up for a showdown. All of this has tempered the king's initial eagerness for a new regime in Syria. ■

Somalia's new government

It mustn't be business as usual

NAIROBI

It is vital that the new government controls the country's ports and trade

A SOOTY new shadow has been cast over Somalia's port city of Kismayo since the militias of the violent Islamist movement, the Shabab, were chased out two months ago. Piled up all over the quay and at the entrances to the city, which is the economic hub of southern Somalia, are dark towers of sacks that locals are calling "skyscrapers of charcoal".

For the past seven months the UN has banned the export of the black stuff. Its trade was an economic mainstay of the Shabab when it controlled Kismayo, earning as much as $50m a year in the taxes levied by the militia, according to the UN. The charcoal business has in any case devastated Somalia's mangrove forests. During the embargo, the kilns kept burning and a vast stockpile was amassed. Since the end of September, when Kenyan forces under the banner of the African Union Mission in Somalia (Amisom) took control of the city, local pressure to lift the ban has grown.

The question of what to do with the charcoal, perhaps worth $40m, could affect the fate of Somalia's new government. Somali businessmen, who want to load the sacks onto waiting ships and sell them in the Gulf states, argue that "you can't turn charcoal back into trees". Others say the traders will turn back to Shabab if they cannot sell their wares. Indeed, quite a few of them still support the Islamists anyway.

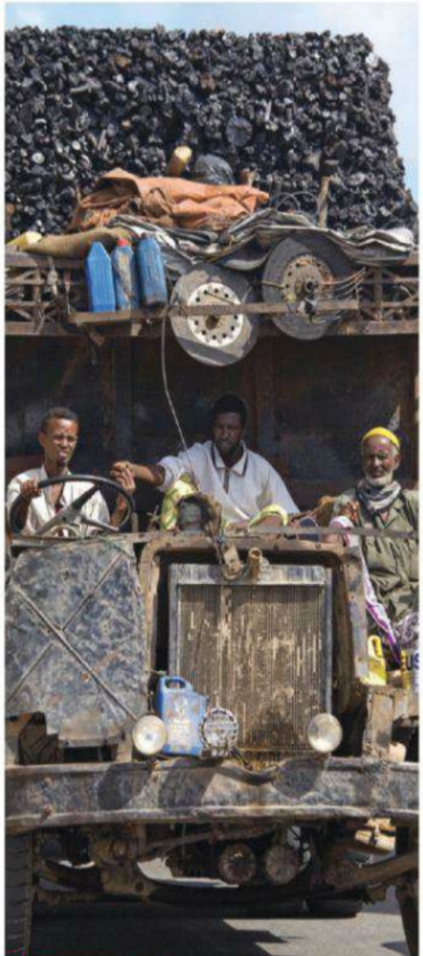
Somalia's new president, Hassan Sheikh Mohamud, a civil-rights man whose election has prompted hopeful talk of a "Somali spring", is trying to stop the export. He wants time to put in place and bolster new port authorities to channel revenues back to the central bank that was emptied by the outgone corrupt regime. If the new man cannot extend his writ to Somalia's second city and his opponents get fresh funds, his government will lose authority almost before its reign has begun.

With a coastline of 2,500km (1,553 miles) enwrapping the Horn of Africa, any effective Somali government needs to control its ports, which served as entry points for the weapons and contraband that sustained both the warlords and the Shabab. Under their rule, Kismayo traders bought sugar, which was smuggled into northern Kenya, and sold charcoal. But this lucrative contraband trade was shut down by an international blockade of the port during the battle with the Shabab.

Influential Kenyans now want to reopen it. Kenya's intervention in Somalia has been fostered by two prominent ethnic-Somali Kenyans, Farah Maalim Mohamed, now deputy speaker of Kenya's parliament, and Mohamed Yusuf Haji, Kenya's defence minister. Their allies in Somalia's Ogadeni clan ran the Ras Kamboni militia that played a big part in pushing out the Shabab. The militia's leader, Ahmed Mohamed Islaan (known as "Madobe"), now expects his pay-off with charcoal, cash and control of a new semi-autonomous state to be called Jubaland. "Promises have been made," says a diplomat in Kenya's capital, Nairobi. A dozen ships laden with charcoal have already sailed, according to sources in Kismayo's port.

At present the port is run by a chaotic security committee on which Kenyans, Ethiopians and several competing Somali clan factions all joust. A presidential delegation from Mogadishu, Somalia's capital, up the coast from Kismayo, was turned away when it tried to visit. At a recent meeting of the UN Security Council, Kenya, along with other governments from the region, argued in vain for the arms and charcoal embargoes to be lifted.

The two main taps that have fed corruption in Somalia have been smuggling and foreign aid. For the first time in many years an administration in Mogadishu seems willing to let foreign donors have a measure of joint control over spending. The new government also wants America and Britain, which have paid for much of Amisom's war on the Shabab, to use their influence to restrain the charcoal-trading Kenyans. "If they're going to allow it all to go back to business as usual," says a member of Somalia's fragile new government, "what have they done all this for?" ■



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German politics

When all parties lead to Angela

BERLIN

Confusion reigns in Germany's party politics. That may not affect who wins next year's election

LESS than a year before Germany's federal election, Chancellor Angela Merkel is doing well, at least at home. Her centre-right Christian Democratic Union (CDU) and its Bavarian sister party, the Christian Social Union (CSU), are leading in the polls. Better still, the other parties are making news either for being in a shambles or, whenever for a moment they are not, for speculation that they might join a coalition in which Mrs Merkel would be senior partner and thus remain as chancellor.

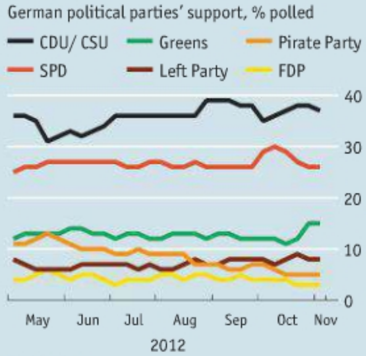
Mrs Merkel's biggest coup has been to remain personally unsullied by the otherwise disappointing performance of the ruling coalition of the CDU and CSU with the smaller Free Democratic Party (FDP). The world might assume that German politics is given over to the country's responsibility to save the euro. Instead, the CSU and FDP have spent most of their political energy on tactical projects that are either daft (for the CSU) or petty (the FDP).

This month, for example, the CSU tried to pander to Bavaria's family-values voters by pushing through a new subsidy to parents who care for toddlers at home rather than sending them to a crèche. Conveniently, the payments will begin next August, just before both the Bavarian and the federal elections. Most parties, notably the FDP, see this policy as an expensive step backwards for a modern society that could leave children of poor families deprived of education. But the FDP accepted it in return for getting rid of a €10 ($12.6) fee that publicly insured patients have to pay once a quarter when they see their doctor.

That the FDP is reduced to horse-trading over such minutiae says a lot about the collapse of this once-grand liberal party. The polls suggest it may get less than 5% of votes in the election, and would thus be ejected from the Bundestag. If an election in Lower Saxony in January confirms such a poor showing, the FDP's leader, Philipp Rösler (who is also economics minister), will surely have to go. There are even rumours of a plot to oust him sooner.

Dancing partners

German political parties' support, % polled



Source: Forsa

With the coalition so preoccupied, the main opposition Social Democratic Party (SPD) might have been expected to attack more effectively. That was the idea behind picking Peer Steinbrück, a famously sharp-tongued former finance minister, as the party's candidate for chancellor. Mr Steinbrück has, however, become embroiled in a sustained debate about the speaking fees he has been earning on the side (€1.25m since 2009, the highest of any Bundestag member). Never loved by his party's blue-collar and trade-union base, Mr Steinbrück, the millionaire, may have turned off many of his erstwhile comrades completely.

It is telling that the SPD chairman, Sigmar Gabriel, is continually having to parry questions about an election outcome in which the SPD would play second fiddle to Mrs Merkel in another "grand coalition", like the one Germany had from 2005-09. Absolutely not, insist both Mr Gabriel and Mr Steinbrück, claiming that they overlap ideologically only with the Greens, the other centre-left party. (The Left Party is still considered too toxic to touch, for it descends largely from the old East German Communist Party, and it is anyway also struggling to stay in parliament.)

The SPD is terrified whenever the Greens generate optimism for the wrong reason: their suitability as an alternative coalition partner for Mrs Merkel. The Greens have been on a roll since capturing the mayorship of Stuttgart, capital of the rich south-western state of Baden-Württemberg, which is also the first and so far only state to be governed by a Green premier. Their success is credited to the dominance within the party's southern branch of the "realo" wing: pragmatists who can ▸▸

appeal to ecologically minded but conservative urban voters. Such "bourgeois" Greens could get along fine with the CDU and CSU in Berlin, goes the thinking.

As if to reinforce this impression, the Greens have just elected Katrin Göring-Eckardt, a leader in the Lutheran church who is from the east and is by Green standards a conservative, as their co-candidate for chancellor. (The other candidate, Jürgen Trittin, was almost preordained, for the Greens always pair a woman and a man.) Ms Göring-Eckardt's selection was a rebuff to Claudia Roth, a flamboyant leftist. The choice immediately renewed speculation about an olive branch to the CDU.

The relative decline of the traditional main parties, the CDU and SPD, in favour of smaller and younger ones, explains much of this party manoeuvring. Some of these may just be fads. The Pirates have done well in four state elections but now seem to be self-destructing, unable to form basic policy and being generally tedious. Yet, as German society becomes more individualistic, says Oskar Niedermayer, a professor at Berlin's Free University, traditional party structures based on interest groups (Catholics, say, or trade unionists) lose appeal, leaving allegiances in flux.

At the same time and despite the campaign rhetoric, the differences between the main parties have, he thinks, got smaller, making any radical change of direction unlikely. That is especially true next year, since it seems increasingly likely that Mrs Merkel, with her safe pair of hands, will continue as chancellor. Only her coalition partner remains to be chosen. ■

The Club Med and the euro

Workers of Europe, protest!

MADRID

A wave of strikes and demonstrations shows the pain across the region

THE first hints of optimism are appearing in Europe's troubled Club Med countries. They are not to be found in unemployment or growth figures, but mostly in the mouths of ministers. "Spain is emerging from its crisis," declared Fatima Bañez, the labour minister, even as unemployment rose above 25%. In Greece ministers are pointing proudly to their progress towards a primary budget surplus. Everywhere economists are welcoming rising net exports and shrinking budget deficits (see briefing, pages 23-24).

Yet ordinary voters and the unemployed are mostly unimpressed. On November 14th in Spain angry protesters took to the streets in the second general strike they have staged in less than a year of Mariano Rajoy's People's Party (PP) government. The strike, and a similar protest in neighbouring Portugal, brought most transport links, schools and many businesses to a halt. Police clashed with violent protesters in several Spanish cities, leading to 118 arrests and over 70 injuries across the country.

Letting everyone know our view of austerity

Millions of people turned out across Europe in the biggest day of union-organised protests since the crisis in the euro first broke out three years ago. Unions in Italy, Greece, France and Belgium joined the action, as workers rejected what they see as northern-imposed austerity. In Rome about 60 protesters were arrested, as civil servants and national transportation workers took to the streets. The strikes in Greece were the third to take place in the space of two months. In all, trade unions from 23 European countries joined in the day of action.

Yet the protests are unlikely to lead to any dramatic change in policy, if only because policymakers are still under huge pressure to reform. The latest European Commission forecasts make grim reading. For the euro area as a whole GDP is expected to shrink by 0.4% in 2012; it is forecast to grow by a mere 0.1% in 2013. Industrial production across the euro zone plunged by 2.5% in September compared with August, the largest fall since January 2009. The figures for the Club Med countries are especially bad. Greece's economy is forecast to shrink next year—the sixth fall in a row.

In Spain the commission predicts that the 2013 recession will be three times worse than the government's forecast, repeating this year's 1.4% shrinkage of GDP. The budget deficit could even rise again in 2014 unless supposedly "temporary" tax rises become permanent. Unemployment could surpass 26% next year. Mr Rajoy's government does not envisage even timid growth until 2014. In the meantime, high borrowing costs are squeezing both the public purse and private businesses.

Spaniards dislike false optimism, which their Socialist former prime minister, José Luis Rodríguez Zapatero, dispensed for many years. Voters evicted his party a year ago, in favour of the greater honesty and realism of Mr Rajoy. Yet now as many as 2.5m Spaniards have been jobless for over a year. Hence the backing for this week's protests.

It would help if Spain requested a soft euro-zone bail-out to trigger a bond-buying plan announced by the president of the European Central Bank (ECB), Mario Draghi. The announcement of Mr Draghi's plan has already lowered borrowing costs and kept markets open. Even if bond yields are now gradually drifting upwards again, Spain has already raised almost all of this year's mid- to long-term funding.

Mr Rajoy insists that he will ask for help from the ECB only when, and if, Spain needs it. That "when" now looks unlikely to be before next year.

The Spaniards also hope that the gloomier economic outlook, and perhaps the widespread protests and strikes, will produce a new dose of realism in the pro-austerity brigade. And on November 14th Olli Rehn, the European Union's economic commissioner, said that Spain's good record on reform meant that the country would be able to miss its deficit targets this year without triggering further austerity. The Swiss bank UBS puts Spain's gross financing needs next year at €250 billion. Mr Rajoy may have escaped a bail-out in 2012, but the markets could yet force his hand in 2013. ■

Turkey and the Kurds

Hunger and thirst

ISTANBUL

A hunger strike causes new tension between Turkey and its Kurds

WHAT happens if they start dying? The question weighs ever more heavily as hundreds of Kurds in prisons across Turkey continue the hunger strike they launched on September 12th. Human-rights activists are saying that many have reached "a critical threshold."

The hunger strikers, surviving on sugar water and vitamins, vow to keep up their fast until the ruling Justice and Development (AK) party meets their demands for greater linguistic rights and better prison conditions for the leader of the separatist Kurdistan Workers' Party (PKK), Abdullah Ocalan. Recep Tayyip Erdogan, the Turkish prime minister, has responded with threats to reintroduce capital punishment, to which Mr Ocalan was sentenced after his capture in 1999 (and which AK abolished when it took office in 2002, in line with European Union demands.)

Mr Erdogan has ridiculed the strikers, growling "let them continue" at a recent AK meeting. When five MPs from the pro-Kurdish Peace and Democracy Party (BDP) said they would join in, a breezy prime minister noted "some of them are in serious need of dieting." Yet the government has conceded one demand with a new bill to allow Kurds to use their mother tongue in court. The EU's ambassador in Ankara, Jean-Maurice Ripert, said this could "create the space for political dialogue."

The Kurds are unlikely to stop their hunger strike until Mr Ocalan is granted access to his lawyers as they demand. Mr Ocalan's status is shrouded in mystery. He has not met the lawyers for 15 months. The government claims this is because the ferry that carries them to his island prison south of Istanbul has broken down. Nobody believes this, not least because Mr Ocalan's younger brother visited him in September. He returned saying the PKK leader was unkempt and was upset by the escalation in PKK violence that prompted Mr Erdogan to scupper secret peace talks.

Yet the younger Mr Ocalan shed no light on whether it was his brother who is shunning the lawyers or the government that is blocking their visits. Proponents of the first theory speculate that Mr Ocalan will not see the lawyers (or ask the PKK to end its violence) unless the government moves him from solitary confinement to house arrest. Backers of the second idea think the government wanted to break the links between Mr Ocalan and his fighters (the lawyers carried messages) in hopes of triggering a leadership struggle that would fracture the PKK.

If so, the strategy has failed. Mr Ocalan's grip may be weaker but he continues to be revered by millions of Kurds. Giant images of the mustachioed PKK leader can be seen throughout Kurdish towns in neighbouring Syria, where an affiliate called the PYD seized control after the withdrawal of President Bashar Assad's troops. Turkey has been lobbying America for a no-fly zone over northern Syria in hopes of squashing the PKK's expanding influence. Wary of wading into further Middle Eastern misadventures the Americans have said no. But in a show of support NATO is expected, at Turkey's request, to deploy Patriot missiles in the province of Kilis, which borders Syria.

The Turkish president, Abdullah Gul, says the missiles would defend Turkey against a possible chemical-weapon attack. Western diplomats suggest that, contrary to reports in the Turkish press, the Patriots could not create a no-fly zone for Syrian rebels and refugees, but are "mostly about making the Turks feel loved." Turkish tanks remain on hills facing a PYD-held town this week after PKK sympathisers fired shots into the air during a funeral last month. If the stand-off with hunger strikers persists, more funerals will follow. ■

Denmark's food taxes

A fat chance

COPENHAGEN

The Danish government rescinds its unwieldy fat tax

FARMERS, retailers and shoppers whooped with joy this week when the government announced the abolition of one of its most hated taxes: a tariff on saturated fats, imposed just over a year ago. The tax was undoubtedly well intentioned. Higher prices for unhealthy foods would reduce consumption and improve public health; obesity levels and cardiovascular disease would fall; strains on health-care budgets would be eased.

Yet in practice, the world's first fat tax proved to be a cumbersome chore with undesirable side effects. The tax's advocates wanted to hit things like potato crisps and hot dogs, but it was applied also to high-end fare like speciality cheeses. One gourmet cheesemaker cut his range of products when his creamy Danish blue saw a price increase of 25%.

Critics saw the tax as the worst excesses of the nanny state. Bakers fretted over the fat content of cupcakes. Pig farmers said their famous bacon would cost more than imports. Independent butchers complained that they were unfairly disadvantaged: supermarkets could keep meat prices down by spreading the tax across other goods, but small butchers sold only meat. This meant higher prices and lower sales.

No more tax, thank God

Besides the bother and cost of installing new systems to calculate the extra tax, retailers were also hit by a surge in cross-border shopping. Family jaunts to Germany or Sweden to stock up on beer, fizzy drinks, butter and sugary delights became a national pastime. One study found 48% of Danes doing some cross-border shopping. A report by the tax ministry put the 2012 value of these trips at DKr10.5 billion ($1.8 billion), a 10% rise on the previous year. Another bugbear was how the tax was applied to meat. It was imposed per carcass not per cut, which meant higher prices for lean sirloin steak as well as for fatty burgers.

Not everybody is happy to see the fat tax go. The Danish medical association accused politicians of putting the economy before public health. And even though some doctors acknowledged that the tax was a blunt instrument, they insisted that one year was too short a time to be able to gauge its impact.

A study by researchers at Copenhagen University into the effect of the tax during its first three months found that sales of margarine, butter and cooking oil had fallen by 10-20% over the previous year. But these data, said sceptics said, were skewed by hoarding in the run-up to the legislation as well as by cross-border shopping in its wake. Unless and until more data emerge, the effectiveness of the world's first fat tax will have been buried under its own controversy.

Charlemagne | Europe's British problem

The rest of the European Union wants Britain in—but not at any cost

ARE the British leaving the European Union? Hardly a conversation passes in Brussels without somebody asking. Britain's friends are alarmed, some rivals gleeful. For the EU as a whole, the prospect of "Brixit" compounds the uncertainty of the euro crisis. Angela Merkel, the German chancellor, says she cannot imagine the EU without Britain. But Michel Rocard, a former French prime minister, speaks for many when he says that "the United Kingdom, which has blocked all progress on European integration since 1972, has distanced itself from the euro zone. Let's take advantage of that."

In many ways, the British have only ever been half-in; they are not part of the euro or the Schengen passport-free travel zone. The prime minister, David Cameron, says that he wants to stay in the EU and its single market (and one day to renegotiate Britain's membership). But some moves give the impression that Britain is on its way out. Its plan to opt out of big chunks of justice and police co-operation is one example. Another is Mr Cameron's threat to veto the EU's next budget unless it is frozen. Most worrying is the drumroll of Eurosceptic MPs seeking an in-or-out referendum. A parliamentary vote calling for the EU budget to be cut suggests that Mr Cameron does not control his Tory backbenchers, and that the Labour Party is ready to exploit anti-EU sentiment.

The rest of the union is in flux, not least because the euro crisis is forcing the pace of political integration. This creates a dangerous cocktail of resentment and unpredictability, and raises the prospect that Britain could find itself outside the EU by error if not by design. Two summits—one on November 22nd to decide the budget, and another on December 13th to forge a euro-zone banking union—may determine whether the EU moves towards a new kind of "variable geometry", or Britain drifts away altogether.

A benign scenario would see EU leaders do a budget deal, clearing the air for one on banking union. This is the first real test of how to balance the integration of the 17 euro "ins" with the interests of the ten "outs", particularly the integrity of the single market of 27. Countries want to place the euro-zone's banks under a single supervisor (the European Central Bank) while reassuring Britain that it will not be outvoted in the European Banking Authority, which sets common rules.

Meanwhile, Mr Cameron's "balance of competences" review will assess the distribution of power between London and Brussels, reporting in 2014. Around that time the European Commission should be setting out its vision of a new treaty, which may include some powers to be repatriated. Mr Cameron, if re-elected, could negotiate the "new settlement" that he seeks and put it to a referendum, perhaps in 2015 or 2016.

British ministers say they want a calm and "grown-up" conversation about the future of the EU. But they may not have that luxury. Much can go wrong, starting with the negotiation over the budget for 2014-20. Britain is the most hawkish country, demanding a real-terms freeze based on spending in 2011. But under pressure from MPs for a cut, Mr Cameron's opening bid may now be his maximum concession. A prolonged stalemate could see the EU budget being rolled over yearly. This would cost Britain more than it wants, and irritate its partners: multi-year projects in eastern Europe would be disrupted, and other net contributors would lose the temporary rebates they now enjoy.

Recrimination over a failed budget could poison the banking talks. An isolated Britain might be tempted to veto the single supervisor. Eurocrats are ready then to push for "enhanced co-operation" that allows nine or more members to seek deeper integration. This could be explosive. Forget sober reflection: Mr Cameron could even be forced to concede an immediate referendum. And other bad scenarios abound. Perhaps the euro will collapse, bringing down the EU with it. Or perhaps the euro will survive, and use its combined weight to push the British around.

Hold your nerve

Still it is hard to see the British, awkward as they are, completely outside the EU. The Germans don't want to be left alone with the protectionist French; the weakened French, on balance, want the British to counterbalance the mighty Germans; smaller countries don't want to be crushed in a Franco-German vice. The Americans want their British ally to stay in. And what would be left of the EU's foreign-policy ambitions without the global diplomatic network and armed forces of the British?

All this may stop events from spinning out of control. Even so, Britain may find European leaders less willing to accommodate its demands in any renegotiation than it thinks. Many see Britain as trying to protect the City, which is hardly popular. The French say repatriating social and employment laws would give Britain an unfair advantage. Even friends in northern liberal countries think Britain goes too far in trying to create an *à la carte* membership. "You cannot just pick the raisins out of the bun," says one.

Several factors are reducing Britain's bargaining power. First is the accumulated resentment of past battles. Second, Germany may feel less necessity to keep the British in, now that their troops no longer defend its borders. Third, unlike Britain, most of the outs want to stick close to the euro zone. Fourth, a looming Brixit makes even friendly countries less willing to line up with the Brits. Most important, most leaders think resolving the euro crisis must take priority over British demands—and they resent Britain's attempts to exploit the euro crisis for its own ends.

A year ago most EU countries sidestepped Mr Cameron's misconceived veto of the "fiscal compact", a treaty to tighten budget discipline. They will do so again if they have to. This may not matter to those wanting Britain out of the EU, but those who still want the best deal for Britain need to keep cool heads. ■

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Crisis at the BBC

Exterminate!

The BBC's troubles have exposed weaknesses in the broadcaster's management—and made future rows over the licence fee more likely

IN RETROSPECT, Mark Thompson achieved something rather remarkable in stepping down as director-general of the BBC in September, after eight years in the job. His predecessor was forced out following a row over a report which implied that the government had overstated the case for war in Iraq. His successor, George Entwistle, lasted less than eight weeks before losing his job on November 10th. He was harmed by the BBC's clumsy decision not to run a report on "Newsnight", a current-affairs show, that would have exposed Jimmy Savile, a recently-deceased presenter, as a serial sex offender. Then came another, worse report that wrongly pointed the finger at Lord McAlpine, a living man with access to lawyers.

Soul-searching, recriminations and a spate of inquiries into what went wrong have ensued. Other executives have stepped down from their jobs (see table on next page) giving the impression of a mighty ship without a rudder. A report into the second "Newsnight" story concluded that basic editorial checks were not completed: the journalists apparently failed to show a picture of Lord McAlpine to Steve Messham, a victim of abuse. The report also pointed to weakness in the editorial command chain. Senior executives including Helen Boaden, the BBC's head of news, and Steve Mitchell, her deputy, had stepped aside from their jobs as an investigation into the failure to air the first (true) Savile story got under way.

The BBC now faces problems both practical and profound. The race for director-general—a prestigious if clearly perilous position—must be run again. More broadly at stake is the credibility of one of Britain's most important national institutions. The BBC is the model for many other post-war broadcasting services and one of the country's best-known exports.

The special relationship

Journalists everywhere sometimes misbehave, and cynically try to shift blame to others when they do. Consider Britain's tabloid newspapers, which are waiting anxiously to hear what Lord Justice Leveson, who has been inquiring into their misdeeds for a year, has in store (see Bagehot). But the BBC's failings are especially troublesome because the corporation depends on public funding to sustain its broad menu of TV channels, radio stations and websites. Public approval of the broadcaster is fairly high, not least thanks to its competent handling of the Olympic games. But polls by YouGov show the proportion of people declaring that they trust the BBC's news journalists has fallen to just 44% from 81% a decade ago.

Built around a structure derived from the civil service, with fixed pay grades and stiff hierarchies, the BBC has long seemed at once over- and under-managed. George Orwell, who worked at the corporation during the second world war, described it in a letter as "something halfway between a girls' school and a lunatic asylum". Big departments like the news division can see several senior figures depart—and new ones rise immediately to take their places. With so many managers around, why venture beyond the organisation?

This insularity makes for a collegial mood, but also for unquestioned orthodoxies and aversions in senior editorial staff—a phenomenon one former BBC boss derides as the "creed of the true believers". The imposition of Orwellian editorial "compliance" standards on programmes after the Hutton Inquiry, which criticised the BBC following the Iraq war row, have reinforced a tendency to refer decisions upward, rather than wield responsibility directly. These safeguards are irksome in normal circumstances and have proved useless in a real crisis.

One question, sparked by Mr Entwistle's painful lack of knowledge about the "Newsnight" reports, is that the director-general's job may be too much for one person. Some politicians are now arguing that it should be split between a chief executive with overall strategic responsibility and an editor-in-chief who oversees news. Alternatively, the role of deputy director-general (dispensed with in a recent cuts round) could be restored. This man or woman would monitor day-to-day activities and keep the new head better informed about editorial matters. Both solutions carry ▸▸

Shakers and movers

Selected BBC management:

Name	Job	Fate	Replaced by
George Entwistle	Director-general	Resigned	Tim Davie *(acting)*
Helen Boaden	Director of news	Stepped aside	Fran Unsworth *(temporary)*
Steve Mitchell	Deputy director of news	Stepped aside	Ceri Thomas *(temporary)*
Peter Rippon	Editor of Newsnight	Stepped aside	Liz Gibbons *(acting)*
Liz Gibbons	Acting editor of Newsnight	Replaced	Karen O'Connor *(acting)*

Likely candidates for director-general:

Tim Davie Acting director-general; **Roger Mosey** Acting BBC Vision director; **Ed Richards** Ofcom chief executive; **Peter Fincham** ITV director of television; **Tony Hall** Royal Opera House

Source: *The Economist*

risks. The first one could create an alternative centre of power in the BBC: during a crisis or an argument about spending priorities, camps could coalesce around the chief executive and the editor-in-chief. The second option adds yet another layer of management. But they seem preferable.

Doubts have also emerged about the BBC Trust, the governing body which is supposed to represent the interests of licence-fee payers. Its combination of roles as BBC cheerleader and de facto regulator looks increasingly unsatisfactory. Beyond its forceful chairman, Lord Patten, it is under-powered, with many members drafted in to represent regional interests.

David Elstein, a former BBC executive turned critic, says "confused governance" and a monolithic news and current-affairs department helped produce recent disasters. He also thinks the BBC's control of an estimated 60% of broadcast news unhealthy. Yet the corporation's dominance of television and radio news is likely to persist. Commercial providers like BSkyB, which runs Sky News, and ITN, which supplies ITV and Channel 4, have little interest in challenging the BBC in areas like foreign news gathering, which is costly and does not attract advertisers. The industry expects a thinning-out of the BBC's top ranks rather than a bracing gust of competition.

The long-term consequences of the BBC's horrible autumn are harder to predict. The next batch of charter-renewal talks, which will set the licence fee, currently £145.50 ($231) a year, is likely to involve a sceptical look at the cost and range of the BBC's operations. A more testing political and public mood may open up more debate about the legitimacy of a state-imposed levy for a single broadcaster.

Meanwhile competition is growing. BSkyB is already the provider of choice for sports fans and lovers of classy American drama. ITV has recommitted to mid-market drama with "Downton Abbey". The BBC has struggled to find a durable comedy hit. The risk, one recent candidate for the top job warns, is that the corporation may find itself overtaken both on creative programming and shrewd buy-ins by nimbler competitors, and left "to do the worthy, expensive stuff". Avoiding that is a mighty task for the BBC's next boss, however long his or her reign. ■

National security

Shadowlands

Britain is heading for more secret courts

TEN years of legal duelling, and pictures of Abu Qatada being ferried from a high-security prison to the bosom of his family are still screaming across Britain's front pages. The government is desperate to deport the Muslim cleric—once described as Osama bin Laden's right-hand man in Europe—to his native Jordan, where he has been convicted in absentia of terrorist charges. The two have tussled right up to Britain's Supreme Court and through the European Court of Human Rights. When the latter denied an appeal by Abu Qatada in May, Theresa May, the home secretary, assumed the man was as good as gone. But a last appeal to Britain's Special Immigration Appeals Commission (SIAC) produced a surprise on November 12th.

Though Abu Qatada himself looks safe from torture in Jordan, the court discerned a real risk that evidence which may have been obtained by torturing others might be used against him, thus denying him a fair trial. David Cameron, the prime minister, Chris Grayling, the justice secretary, and Theresa May, the home secretary, are enraged. Mrs May is expected to appeal within days. More promisingly, Jordan seems willing to do whatever is needed to shore up confidence in its judicial system.

For once, where human-rights decisions are concerned, Europe is not to blame: it was a British judge who found for Abu Qatada. And by curious coincidence, the case has drawn attention to a peculiarity of British justice, not failings elsewhere.

The hearing over which Mr Justice Mitting presided was a Closed Material Procedure (CMP), in which evidence deemed threatening to national security was not revealed to the appellant or his lawyers—in other words, a secret trial. Although it is unlikely that this material was central to the outcome of the case, the public will never know, and neither will Abu Qatada. The judge produced two judgments: an open one for all to see and a closed one.

SIAC was set up in 1997 to deal with appeals when the home secretary had directed that a person be deported on national-security grounds. Secret proceedings were permitted. CMP fans argue that at least judges get to see sensitive information; the alternative is for the government to withhold it and try to argue its case on other grounds. The use of CMPs has spread a bit but has not been allowed in civil cases—for example, those dealing with damages. Now a bill allowing just that is heading to the House of Lords for further debate.

Binyam Mohamed, a British resident detained in Guantánamo Bay, has a lot to do with this. In 2010 he and other detainees brought a civil claim for damages against the British government, arguing that the security service and others had been complicit in their detention and ill-treatment by American forces. Unwilling to produce sensitive evidence in open court, and unable to win the case without it, the government settled, paying a reported £20m ($32m). More claims for damages are kicking around. If secret courts are used in dealing with them, the government can attempt to exculpate itself without revealing confidential information.

Will these bits of the Justice and Security bill be adopted? For many, secret courts are a perversion of justice, and extending them unthinkable. The Liberal Democrats voted at their party conference in September against expanding their remit. Sadiq Khan, Labour's shadow justice secretary, speaks out against it too—though his party's own record in power is one of whittling back civil liberties. David Anderson, the independent reviewer of terrorism legislation, believes there is a small role for CMPs, but that the bill needs amending—mainly to put more power in judges' hands, and less in ministers'. Expect some changes, but the bill is likely to be law before Abu Qatada finally leaves Britain. ■

Bagehot | Judge dread

The real problem for the tabloid press is that politicians are losing their fear

"THERE could be no greater example of a failure of ethics and standards than the BBC's covering up of the Savile scandal," thundered the *Daily Mail*, a best-selling newspaper. Well, maybe. Sloppy and neglectful as the BBC has been, it is unclear to what extent it covered up the predations of its former employee, Jimmy Savile. Nor is there any suggestion that the broadcaster deliberately misled viewers in its more recent blunders at "Newsnight". It has been badly run, but BBC journalists are mostly law-abiding and respectful of the truth. That cannot be said with much confidence of Britain's popular press.

Even veteran observers of Grub Street have been appalled by some of the testimony heard by Lord Justice Leveson during a Herculean trawl through the Hades of British press standards. Launched last year after revelations that journalists had hacked the mobile-phone messages of a murdered schoolgirl, Milly Dowler, the Leveson Inquiry has heard anguished testimony from celebrities and ordinary folk badgered by hacks. Dozens of journalists (none of them from the *Daily Mail*) have been arrested in connection with investigations into phone-hacking and bribery of policemen.

The Leveson Inquiry is an important subtext to the *Daily Mail*'s invective against the BBC. Like other broadcasters, the BBC is overseen by a powerful, independent regulator. Newspapers, both broadsheet and tabloid, fear Lord Justice Leveson is about to propose something similar for them. The BBC's recent example suggests this would not lead to error-free journalism. Yet that is the least of the newspapers' hostility.

Most papers accept that the existing Press Complaints Commission (PCC), a soft and gummy instrument of self-regulation, must be replaced by something toothier. But they argue that enshrining its independence in law, as Lord Justice Leveson has already indicated he wants to do, would put the Fourth Estate on a slippery slope towards parliamentary control. They also complain that the new commentariat of bloggers and tweeters would be exempt—an irksome exception at a time of slumping circulation, when papers are trying to make online journalism pay.

Instead, the newspapers have united behind an alternative proposal for a tough independent regulator with powers to investigate misdemeanours and levy fines of up to £1m ($1.6m). This would be voluntary, like the PCC. Yet the newspapers claim all would sign up to it rather than invite a tougher, legally underpinned alternative. Having done so, they would be bound to its strictures by five-year contracts. (*The Economist*'s own solution is for a similar tribunal which would also be a first stop for libel cases—an area where English law is draconian).

The indication, however, is that Lord Justice Leveson, whose inquiry has sadly focused on tabloid rather than serious journalism, considers self-regulation too weak. That puts David Cameron in a bind. The prime minister is thought reluctant to pass any law to bring the press to heel both by conviction and in fear of inviting the wrath of the right-wing press. The *Daily Mail*, *Daily Telegraph*, *Sun* and *Times* are already scathing of Mr Cameron.

Failing to heed Lord Justice Leveson would scarcely be easier for the prime minister, though. It would invite a question of why he set up the inquiry in the first place; and it would be unpopular. Journalists are currently level-pegging with politicians as Britain's least trusted group. And though the Leveson Inquiry suggested that politicians are not quite as in hock to press barons as some suppose, it produced plenty of embarrassments. One was a text message from News International's former chief, Rebekah Brooks, wishing Mr Cameron luck before a big speech, because "professionally we are definitely in this together." Mrs Brooks is now awaiting trial for conspiring to hack phones, as is Andy Coulson, a former editor of the *News of the World* who became Mr Cameron's press officer. Failing to face down the newspapers, says a gleeful Labour politician, would leave the prime minister "hugely exposed once his best friends are in the dock."

The pen and the sword

Mr Cameron's cabinet is divided, with several ministers opposed on principle to bringing the press under any form of statutory control. Appearing before the Leveson Inquiry, Michael Gove, the education secretary and a former journalist, warned that this was a threat to press freedom. Boris Johnson, the mayor of London and another sometime hack, shares that view. Parliament as a whole may not. Labour appears ready to sign up to more or less whatever Lord Justice Leveson proposes. So, more cautiously, is Mr Cameron's coalition partner, Nick Clegg.

Yet the most intriguing support for a regulator backed by statute comes from within Mr Cameron's own party. On November 8th 42 Tory MPs and two peers wrote a letter arguing for it on the basis that the newspapers' own proposal "risks being an unstable model destined to fail." There is speculation that this was designed, with Mr Cameron's foreknowledge, to give the newspapers pause. Yet it is striking how unabashed the signatories were. They include a conspicuous number of recent MPs, an independent-minded and often technophile bunch. The vengeful press holds less fear for them than for their predecessors, one of these MPs suggests, because they have fewer skeletons in their closets and are likelier to be engaged with voters directly through social media rather than through newsprint. A *Daily Telegraph* article, which seemed to shoot across their bows by pointing out that some of the 44 may, in the past, have had reason to resent nosy reporters appears to have stiffened spines and aided recruitment to the statutory cause.

That suggests the press's hour of reckoning may be unfortunately timed. Newspapers are still formidable enough for politicians to want to see them tamed. But they are now weak enough for that to seem possible. ■

Also in this section

Gay marriage

To have and to hold

The trend toward giving homosexuals full marriage rights is gaining momentum

FOR the first time in America, three states voted on November 6th to allow gay couples to wed—ending a succession of electoral defeats for the measure in 32 states. A fourth state rejected a proposed ban. In Catholic France the new Socialist government has just approved a bill to permit same-sex marriage. New Zealand is preparing to pass similar legislation next year. Governments in England and Scotland have also pledged to do so soon. And in Spain a gay-marriage law passed seven years ago has finally been given a seal of approval by the Constitutional Court.

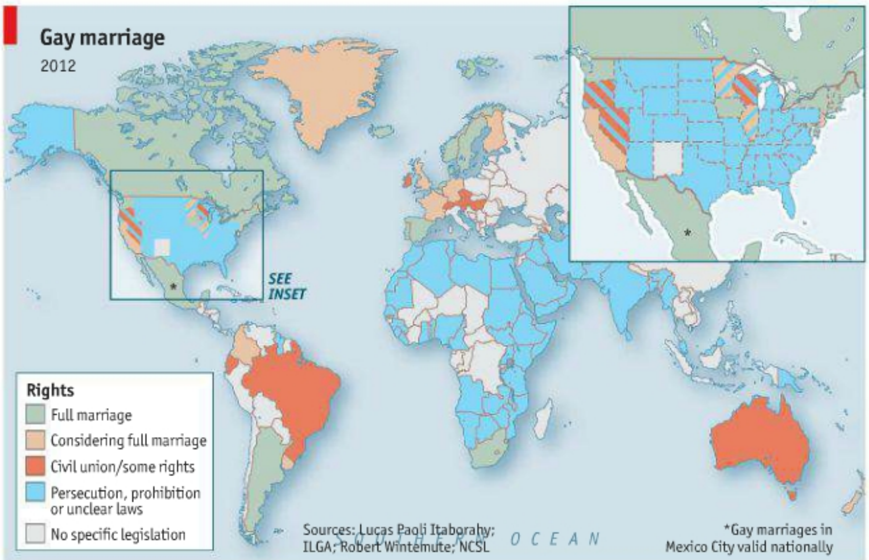
Just a dozen years after the Netherlands became the world's first country to legalise gay nuptials, the global trend toward giving homosexuals full marriage rights seems to have gained unstoppable momentum. Same-sex marriage is now legal nationwide in 11 countries (see map), including Argentina and South Africa, as well as in parts of a further two. In Mexico it is allowed in the capital. In America nine states along with the capital have legalised it, mostly as a result of court challenges.

That said, in 78 countries—mostly in the Muslim world, Africa and other developing states—gay sex is still a crime, punishable by long prison terms and even death. Opposition against gay marriage remains fierce, particularly from churches, conservatives and some politicians. Rick Santorum, a former Republican presidential candidate, has described the legalisation of gay marriage as "a turning-point in American history", saying it would do more to destroy the church and the family than any other movement. Others have gone further, talking of a "slippery slope" leading to a generalised acceptance of incest, bestiality, paedophilia and other horrors.

But attitudes are changing—and fast. Fifty years ago homosexuality itself was still a crime throughout most of the world. Britain decriminalised it only in 1967 and it was not until 2003 that America's Supreme Court struck down the remaining sodomy laws in 14 states. Now, across most of the West, polls show a majority of public opinion in favour of equality for gays, including allowing them to marry and adopt children. Ten years ago two-thirds of Americans were opposed to gay marriage; now more than half, including most Catholics, are in favour. Similar trends can be seen in other Western countries.

As attitudes have shifted, laws have changed. When Denmark became the first country to allow "registered partnerships" for gays, in 1989, it was seen as revolutionary. Now most Western countries allow some kind of "civil union" giving homosexuals most of, if not all, the same rights as married straight couples or else full-blown marriage, with the former usually preceding the latter.

Why this rapid shift, which has taken even many activists by surprise? It is partly ▸▸



generational. Younger people, brought up in a more tolerant age, simply cannot understand what all the fuss is about. But it is also a result of changing behaviour among gays themselves. As homophobic laws have fallen, so more homosexuals have come out. And as their straight neighbours see them leading normal happy family lives—including bringing up children—without the world falling apart, they become more widely accepted.

Lesbian, gay, bisexual and transgender (LGBT) activists have also changed their tactics, getting better organised, raising funds, and going out to educate people. In this month's elections in America the gay-rights movement spent $33m promoting gay marriage in the four states where it was on the ballot—three times the amount their opponents were able to drum up, and a complete reversal of the situation in the 2008 elections.

At the same time, the churches, most of which regard gay sex as a sin, are losing some of their influence. A recent survey of Americans' religious beliefs by the Pew Research Centre showed one in five adults saying they had no religious affiliation—double the proportion 20 years ago. Three-quarters of these so-called "Nones" support gay marriage. In another study, 42% of Britons described themselves as atheists or agnostics—three times as many as in the early 1960s. In France only 7% of Catholics continue to attend mass at least once a week; 58%, including three-quarters of those aged under 35, never go.

In America, where Barack Obama recently became the first president to endorse gay marriage, Gene Robinson, the Anglican Church's first openly gay bishop, talks of a "sea change" taking place. The 1996 federal Defence of Marriage Act (DOMA), restricting marriage to the union between a man and woman, has increasingly been coming under legal challenge, with two federal appeals courts holding it to be unconstitutional. On November 30th the Supreme Court may take up one of several gay-marriage cases before it. If, as activists hope, it decides in their favour, the ruling could prove as much of a watershed for gay-rights as the court's landmark sodomy decision in 2003.

Whatever happens, activists will push on. They have never been happy with being fobbed off with civil unions. Like most straight couples, they want the stability, security and dignity brought by marriage. As Jonathan Rauch, a gay American author wrote in his book on gay wedlock, the essence of marriage is not sex or children or even self-fulfillment, but rather a lifelong commitment, recognised and supported by society, by two people to "have and to hold...for better for worse...till death us do part." Not all gay couples will want to marry, anymore than all straight couples do, but they do at least want the option. ■

Private soldiers

Bullets for hire

The business of private armies is not only growing, but changing shape

OVER the past decade the business of renting out private soldiers has grown from a specialised niche into a global trade, worth as much as $100 billion, according to the United Nations. When the American consulate in Benghazi, Libya, was torched in September, locals hired by Blue Mountain, a British firm, were on guard. When a few weeks later African Union forces kicked the Shabab, a terrorist group, out of Kismayo, Somalia, South African private soldiers gave them training and support. In Iraq and Afghanistan more than 20,000 private guards are employed by the American government.

The industry's growth has been paid for by Western governments, keen to limit the political cost of military boots on the ground. Supply has also come mostly from the West: 70% of firms are British or American. As the big conflicts of the past decade come to an end, however, private armies are beginning to chase new business, according to Sean McFate of America's National Defence University. Industrial firms, which are increasingly setting up shop in unstable places, are expected to be a growing chunk of the customer base.

One company, in particular, is preparing for the change: Academi, an American private military giant (which, before it was sued over the death of 17 civilians in Iraq in 2007, carried the less silly moniker of Blackwater and in 2009-11 was called XE Services). More than 90% of the firm's business to date has come from governments, but it thinks that in the future half of its customers could be corporate. Among the early adopters are energy firms and a hotel chain. By the end of the year Academi expects to have opened a new "several thousand acre" training site, probably in east Africa, to help meet the changing demand.

On a wild geese chase

As the market opens up, non-Western firms want a piece of the action. When Chinese road workers were kidnapped in South Sudan in January, Chinese armed guards were enlisted to help secure their release. One firm based in Beijing, Shandong Huawei Security Group, says it has hired about 100 guards for overseas work, and is looking for jobs in Iraq. In Angola, where more than 260,000 Chinese live and work, private firms keep them safe from banditry.

Moreover, big firms keep spawning smaller, local outfits. Large companies entering a new area typically employ locals as subcontractors. Emboldened by their new training, "subs" can spin off when a job ends, as a pool of hardened guns for hire. In June a UN monitoring group found a private anti-piracy unit in Somalia to be among the best-equipped forces in the region; it had been started with the help of Erik Prince, the former boss of Blackwater.

Small, informal groups are a particular cause of concern. They might work for the highest bidder, whether an oil firm or a frustrated despot (Colonel Qaddafi hired mercenaries in the weeks before the Libyan revolution that killed him in October last year). Mr McFate worries about the long-term impact of these private armies. As in 16th-century Europe, he says, Africa's rich may employ mercenaries to carve out regions of control, leaving those left outside to fend for themselves.

A more immediate issue is how to regulate the fragmented industry. Ted Wright, the boss of Academi, says that its leadership has been completely replaced since the Blackwater days, and now makes subcontractors sign a set of rules and work under observation. Several states, including China, have signed the Montreux Document, a voluntary code of conduct.

Yet self-regulation is unlikely to be sufficient in a business known for its cut-throat competition. Some say that private firms should be barred from jobs more suited to conventional armies, and governments should impose sanctions at home for infractions abroad. But making rules that apply internationally will be difficult, says Thomas Hammes of America's Institute for National Strategic Studies. Corporate responsibility, however, might help. Customers need to ensure that those hired to protect their sites are qualified and accountable—with the UN, itself a customer, taking the lead. Otherwise, the market for private soldiers might spin out of control. ■

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Chinese e-commerce

Pity the parcel people

SHANGHAI

Online sales are booming in China. But where are the profits?

IT IS "one of the few bright spots in the Chinese economy," says Zeng Ming. He is talking about e-commerce. Mr Zeng, the chief strategy officer for Alibaba, a giant Chinese internet firm, predicts that digital transactions on his firm's platforms will top 1 trillion yuan ($159 billion) this year—more than Amazon's and eBay's combined. That is a bold claim; but consider what happened on Singles Sunday.

Invented a few years ago by students and seized upon by digital marketers, this festival for lonely hearts falls annually on the 11th day of the 11th month (since 1 is the loneliest number). It is like St Valentine's Day, only worse. Singletons shower each other with tender gifts: a barrage of pearls; a storm of sweets.

This November 11th they spent a staggering 19 billion yuan on Alibaba's online platforms—a fourfold increase on a year ago, and more than double what Americans spent online last Cyber Monday (the Monday after Thanksgiving, when retailers urge Americans to shop online). More than 100m purchases were logged, accounting for 80% of the packages shipped that day. Couriers were buried in parcels.

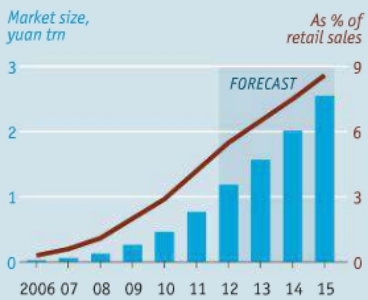
So life is good for China's etailers, then? Not exactly. The number of digital marketers is increasing and online sales are booming (see chart). Consumers are enjoying lower prices, better service and more variety. The problem? The pressure on margins in Chinese e-commerce is worse than in America, reckons Elinor Leung of CLSA, a broker. "Almost no one makes money," she says.

The fiercest battles are being fought between online retailers and their bricks-and-mortar rivals. Dangdang, a firm that resembles Amazon, and 360buy, another online retailer, have cut prices ferociously. Tencent, a cash-rich online giant known for its instant-messaging software, is splashing out to win market share. 360buy has also just raised $400m from investors to do the same. But it is unclear how much longer such firms can burn through capital.

That is especially so since physical retailers are fighting back. Walmart has increased its stake in Yihaodian, a local e-commerce firm. Jeff Walters of BCG, a consultancy, argues that in a good year a retailer like Walmart could open 40-50 physical stores, just a sliver of the Chinese market, "which is why e-commerce is so important for them here". Many Western rivals have flopped in China with the big-box strategy; including, most recently, Best Buy (an electronics chain) and Home Depot (a do-it-yourself shop).

A billion fingers clicking

China's e-commerce market



Source: iResearch

Suning and Gome, big Chinese high-street electronics stores, are putting an expanded range of products on their websites. Alan Lau of McKinsey & Co, a consultancy, says they are also pushing manufacturers to stop offering etailers such big discounts. He estimates that in 2011 computers and handsets sold online were 12% cheaper than in stores; this year they are only 7% cheaper. As the gap gets smaller, so do nearly everyone's margins.

The great exception is Alibaba, which handles nearly three-quarters of China's e-commerce. Because its Taobao (consumer-to-consumer) and Tmall (business-to-consumer) platforms connect buyers and sellers, the firm does not carry the cost of logistics or inventory. It makes none of the products it sells. (American officials have branded it a "notorious" counterfeit market, a charge Alibaba deems unfair.) It makes money chiefly through advertisements, not user fees, a model that works thanks to its dominant position.

Privately held Alibaba does not discuss its finances, but Yahoo! owns a stake (which it is winding down). The American internet firm's disclosures this month reveal that Alibaba's revenues nearly doubled year-on-year, to $2.9 billion for the three quarters ending in June. Its profits tripled to $730m over that period.

Alibaba is bullish. In China e-commerce already accounts for nearly 5% of total retail sales, roughly the same as in America. But its potential is greater, argues ▸▸

the firm. In America, physical retailers are already efficient and everywhere. In China, they are highly fragmented, inefficient and barely visible outside big cities. So etailers could leapfrog them.

Mr Zeng notes that legions of Chinese have yet to go online. As they do so, Alibaba will be watching, recording and analysing their shopping habits. The firm is devising a "big data" strategy. It hopes to help vendors harness customer information quickly and share insights among themselves. This could allow them to accelerate product-design cycles.

The firm's lofty ambition is to help China move towards "mass customisation" and "user-generated innovation"—turning trendy jargon into reality. "The entire supply chain will sit on e-commerce," insists Mr Zeng. "It will be not just a tool, but the heart of the entire economy." ■

Tobacco regulation

Look what they've done to my brands

Cigarette-makers will weather the spread of plain-packaging laws

AUSTRALIANS call them Winnie Blues. But their favourite cigarettes will lose their familiar blue and white livery under Australia's new plain-packaging law, which takes effect on December 1st. From then all cigarettes must be sold in identical packs ("drab dark brown" is the approved colour) with the brand name set in standardised type. The tobacco companies are angry. Plain packs are "plain stupid", declares the website of British American Tobacco (BAT), the second-largest non-state producer. New Zealand, Britain and the European Union are contemplating plain-pack laws of their own. Everyone is watching the Australian experiment.

It ought to be a disaster for big tobacco. Governments started banning cigarette advertising on television in the 1960s, and though the marketing noose is still loose in much of the world it is tightening. Many governments ban ads in print media and at the till and oblige manufacturers to emblazon packs with gruesome warnings. The pack itself survives as a badge of a smoker's taste and means, displayed and pocketed 20 or 30 times a day. Lighter colours hint at relative healthiness. Tall thin packs seem more feminine. In the war on tobacco marketing, packaging is "the last major frontier", says David Hammond of the University of Waterloo in Canada. "That's why we're seeing such strong opposition."

But tobacco is a weirdly resilient industry. Consumption is shrinking in developed countries but still rising in poorer ones, thanks partly to their growing populations. As GDP rises, smokers trade up to more expensive brands. The number of cigarettes smoked globally will shrink by 9% between 2015 and 2050, predicts Euromonitor International, a market-research firm. But tobacco firms are adept at wringing fatter profits from stagnant markets.

Choose your poison

Addicted customers and high taxes make it relatively easy to raise prices (a big rise for producers translates into a small uptick for consumers). Tobacco's stigma keeps potential competitors at bay. BAT aims to raise its earnings per share annually by high single digits and often does better than that, partly by using its spare cash to buy back shares, points out Rae Maile of J.P. Morgan Cazenove. Philip Morris International, BAT's bigger rival, has retired a quarter of its shares since 2008.

Big Tobacco can hardly complain that plain packs will dent demand. It insists that branding is all about market share, not recruiting new smokers. Really? The World ▸▸

Sierra Leone

Of polls and profits

FREETOWN

With democracy comes capitalism

POSTERS plaster Freetown, the capital of Sierra Leone. With an election on November 17th, candidates are vying for votes. President Ernest Bai Koroma is bidding for re-election with snappy slogans such as "When Music is Nice We Play it Twice" and "De Pa Dae Woke", which means "The Father is Working".

Whoever wins, the ballot creates opportunities for businessmen such as Mohamed Taleb, a recent immigrant from Lebanon. Mr Taleb runs the printing operation for a firm called Protec in Freetown. His workshop ran off some 5,000 square metres of banners for Sierra Leone's two main parties. The ruling All People's Congress (APC) ordered about $20,000-worth; the opposition Sierra Leone People's Party (SLPP) a quarter as much. "They just rely on me for what I do," Mr Taleb says.

It is ten years since Sierra Leone's terrible, hand-chopping civil war ended. The poll is a test of the nation's stability. But voters still like to be given goodies, such as T-shirts, caps, scarves and wristbands in party colours.

A lot of the election tat is made in China. Qifei Liang, a 28-year-old Chinese trader, struck a deal with the SLPP to bring in 6,000 T-shirts. The deal is worth $30,000, but so far he has received only $4,000. The rest is due by the end of November. Mr Liang is a little nervous.

Voting is priceless; T-shirts are cheap

Local traders are importing election goodies from China, too. Kada Enterprises on Freetown's ECOWAS Street brought in two 40-foot containers. The $150,000 deal included 12,000 APC and 9,600 SLPP T-shirts and 72,000 caps to keep off the sun. Nearby Sulaiman Kamara has brought in 90,000 T-shirts. He is cagey about prices. "Making a profit is one; assisting our people to go through the campaign is another profit," he says.

Health Organisation reckons that a blanket advertising and promotion ban would cut puffing by 7%.

Kingsley Wheaton, BAT's head of regulation, says the injury lies elsewhere. For one thing, Australia's law amounts to an expropriation of intellectual property, which ought to worry other industries such as food and liquor. Australia's High Court rejected that claim, but the World Trade Organisation is considering it.

The second claim is that plain packs will drive smokers into the black market, which would be the fourth-biggest manufacturer if it were a company. Mr Maile sees this as the main threat to the business. Plain packs will encourage counterfeiters to produce knock-offs of many brands rather than just a few, he thinks. And that, the cigarette-makers gleefully point out, will cut government revenue.

They are nothing if not ingenious; when regulators banned "light" they struck back with "smooth". Plain packs will not end the duel. BAT will go back to the "core of our product" by upgrading flavour and other inherent qualities rather than investing in promotional pizzazz, says Mr Wheaton. After all, fine wines do not sport flashy labels.

Plain packs may chime with a global back-to-basics mood. Some analysts think they could even help brands in their endless quest for differentiation. Faced with rows of identical boxes Aussies will ask for their favourites by name. New brands will find it hard to break in. Incumbents may find the new regime rather cosy. ■

Video games

Japan fights back

TOKYO

Two Japanese firms are challenging the world to a new kind of video game

ONE of the latest hits from DENA, a Japanese mobile-gaming company, is called "Blood Brothers". The hero is a vampire who unites his allies against his enemies in a pact of blood. But that's not the scary part.

On Google Play, a social-gaming site where "Blood Brothers" is the current top-grossing American game, the fans' reactions include: "very addictive", "very fun and addictive" and "so addictive". Could it be that, after years of waning popularity, the world is once again falling in love with Japanese video games? And although reviewers have been jovially describing good games as "addictive" for years, might the fun be wearing thin? Are some of these new products so compulsive that people should worry about them?

In Japan, DENA and GREE, its local rival, have become household names in the past few years. Already, they challenge Nintendo and Sony. Their business model is based on "freemium" social games that cost nothing to download to a mobile phone or tablet, but charge small fees—say, ¥100 ($1.25)—for add-ons that bolster the chance of winning.

DENA, which claims 45m users for its Mobage (pronounced "Mobagé") platform in Japan, made an operating profit of ¥20.4 billion in the quarter that ended on September 30th. That is more in three months than Nintendo hopes to make for this whole year—even with the launch of its new Wii U console this month. On November 14th GREE said its operating profits were ¥15.75 billion, down 5% on the previous quarter.

Fun on the phone

Japan's gaming market by type, $bn

Sources: CLSA; Capcom

Neither company wants to focus only on Japan. Both are paying fortunes to buy games developers in order to expand in America, Europe, China and South Korea. Isao Moriyasu, DENA's boss, takes his cue from console manufacturers, which he says sell seven times more goods outside Japan than inside. He thinks Japan's ¥500 billion social-mobile games market could expand as much globally.

Yoshikazu Tanaka, the 35-year-old founder of GREE (and Asia's youngest self-made billionaire), believes that if you add in emerging markets the growth potential soars. The rich world, he says, grew up playing costly games on consoles. The developing world is being introduced to free games via smartphones. There may be ten times as many smartphone gamers as console users, Mr Tanaka reckons.

That means nothing if you cannot make money, but DENA and GREE insist they can. Their combined revenues and profits last year exceeded those of Facebook, the billion-strong social network. In contrast, Zynga, the biggest global games provider on Facebook—and until recently a darling of the casual-gaming business—lost $400m.

The secret of their success, they say, is their head start in Japan thanks to fast mobile-phone networks that made it easy to play games while commuting, or during spare moments. By studying their customers, they learned a lot. DENA, for example, found that the average user played for seven minutes, five times a day. So casual gamers need shorter, punchier games than do hard-core gamers who goggle at big screens for hours at a time.

As the power and popularity of smartphones has grown (see chart), games have become more sophisticated. As platforms for gaming, phones and web browsers have advantages over consoles: DENA first puts out its games on browsers rather than applications, which allows for "tweaking and tuning" in real time, says Mr Moriyasu. A Japanese game may be only 20% completed when it is made available to gamers. Its developers believe this enables them to finesse it, so that it stays popular for longer. For example, Mobage's "Rage of Bahamut" has been all the rage since April.

Critics, however, argue that such fiddling is used to hook the customer at his weakest point and to extract huge sums of money in add-ons. They note that neither company gives a full breakdown of revenues per user, so it is hard to know how much is generated from the most obsessive gamers. This poses a regulatory risk. In May Japan's Consumer Affairs Agency cracked down on an aggressive sales technique called "complete gatcha", in which users collected randomly generated tokens that the regulator likened to a slot machine. Some children were forking out tens of thousands of yen on their parents' accounts, it claimed.

GREE and DENA say they have since stopped the practice. This month they set up a self-regulatory body in Japan to offer guidance to youngsters. "We don't want our users to spend too much. It's very important to become a sustainable business model," says Ryotaro Shima, head of GREE's European arm.

Still, both firms are ambitious: they say they want to become the "Facebook of social gaming". And why not? Japan has shown the way in video games, from Space Invaders to Nintendo's Super Mario. If DENA and GREE fulfil their ambitions they would become one of the first internet platforms outside Silicon Valley to become truly global. That's a goal that both of them think is worth fighting for. ■

Canadian energy

The sands of grime

FORT MCMURRAY

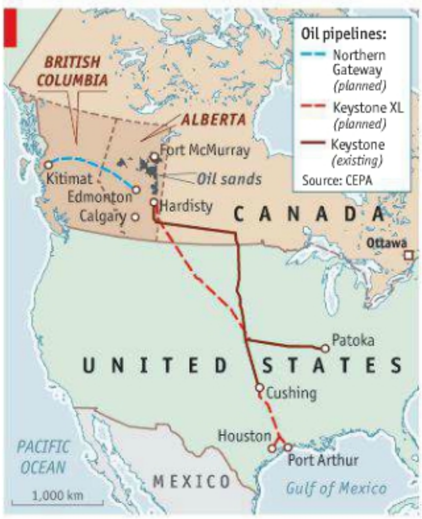
To become an energy giant, Canada needs capital, people and pipes

THE oil town of Fort McMurray gets a bad press. GQ magazine portrayed it as a hellhole of testosterone and tattoos, where drunken oilworkers shower strippers with cash and get into fights because there's nothing else to do. *Esquire* called it "the little Canadian town that might just destroy the world".

There is a grimy grain of truth in such stories. Extracting oil from Alberta's oil sands does indeed cause environmental problems. And Fort McMurray is a bit macho. It is a frontier town of ultra-low temperatures (-20°C is about average in winter; -51°C has been recorded) and ultra-high wages (average household income is C$178,000, which is also $178,000). The population is mostly young and male. Some do indeed prefer more raucous entertainment than say, joining a book group to discuss "Eat, Pray, Love". "I wish they'd ban truck nuts," sighs a female resident, referring to the toy testicles with which some young men decorate their trucks.

But there is another story about Fort McMurray: a tale of innovation and energy reserves so vast that they could have geopolitical consequences. Canada's oil sands contain some 170 billion barrels of oil that can be recovered economically with today's technology (and perhaps ten times that in total). Canada thus has the world's third-largest proven oil reserves, after Saudi Arabia and Venezuela. And since most oil-rich nations' reserves are under state control, Canada has the largest reserves that private companies are free to invest in—more than half of the global total, reckons Ken Hughes, Alberta's energy minister.

Other countries welcome the idea of plentiful energy from a stable democracy. It could reduce the rich world's dependence on the Middle East. There are "no bribes or body bags", grins an oil-industry booster. And the potential is immense. A new study by the Alberta Geological Survey estimates that the province has huge resources in its shale beds as well as its oil sands: 3,400 trillion cubic feet of natural gas and 420 billion barrels of oil—numbers comparable to America's.



However, Canada's output of 3.5m barrels of oil a day is less than half that of America. (America's output is set to exceed Saudi Arabia's; see next article.) Several problems hobble Canadian energy: geology, capital, people and pipes.

First, geology. Canadian oil is hard to extract. It mostly comes in the form of bitumen, which is "hard as a hockey puck" at 10°C, as the Canadian Association of Petroleum Producers (CAPP), an industry body, puts it. If it is far below ground, it must be blasted with steam to make it flow, and then pumped out. This process (known as "steam-assisted gravity drainage") was developed in Alberta. In the past decade, with high oil prices, it has made the oil sands economical to exploit. But precariously so: the best projects break even when oil is $30 a barrel, but many new ones need it to be $80 or more. (West Texas Intermediate is currently $85.)

Canada gets less than it should for its oil because it lacks enough pipelines. Environmentalists oppose them, arguing that pipes leak (which is always possible) and that Canada's heavy oil causes more greenhouse-gas emissions than other oil (which is true, but not by much). President Barack Obama has delayed the approval of a pipeline called Keystone XL, which would move Canadian oil to America's Gulf coast. A decision is expected soon.

Alex Pourbaix of TransCanada, the firm behind the Keystone pipeline, insists that the project will be good for both countries. Canada forgoes a fortune—perhaps $20 a barrel—because it cannot get its oil to the sea. Canadian gas sells at a discount, too: North American prices are far lower than those in Asia.

Getting the oil to the sea

Another proposed pipeline, Northern Gateway, would carry oil to Canada's west coast, whence it could be shipped to Asia. Canada would benefit from having a choice of customers. But the government of British Columbia, and various aboriginal groups, have yet to say yes.

To exploit its hydrocarbons, Canada needs capital: some $50 billion-60 billion a year, on recent trends. Such sums are "far more than Canadian capital markets can raise," says Dave Collyer of the CAPP. Canada gets plenty of foreign investment: Syncrude, one of the biggest oil-sands developers, is a joint venture that includes American, Chinese and Japanese partners. But lately the country has grown frostier towards foreign capital.

In October Canada's federal government temporarily blocked a $5.2 billion bid by Petronas, Malaysia's state energy giant, for Progress Energy Resources, a Canadian natural-gas company. It has yet to approve a $15 billion offer by CNOOC, a Chinese state-owned firm, for Nexen, a Canadian oil-and-gas firm. A deadline passed last ▸▸

week; a decision may come next month. Mr Hughes says he is keen on foreign investment so long as foreign firms abide by the same rules as Canadians; but it is not up to the provincial government.

The other big bottleneck is human capital. Hardly anyone lives near the oil sands, so labour must be imported, from other parts of Canada and from abroad. People from 127 countries live in Fort McMurray, says Ken Chapman of the Oil Sands Developers' Group. They speak 69 languages. The Walmart in town looks like the United Nations, except that all the shivering Africans are buying woolly hats. Mr Hughes expects to see a skills shortfall of 100,000 people in Alberta by 2017. Canada's immigration rules are more liberal than America's, but firms still gripe about delays. An Irish worker in Fort McMurray complains of having to fly to Calgary to sit a test of English proficiency. It's her native language, and the test is online.

Companies poach staff from each other, bidding up labour costs. It would be easier to attract workers to Fort McMurray if the town were more liveable; a one-bedroom flat can cost $2,000 a month. To build more homes, however, the town must wrestle with provincial red tape—and also attract legions of builders, plumbers and electricians, all at inflated wages.

Working conditions in the oil sands are tough. Touch a metal pipe with your bare hand at minus 40 and it sticks. "It's not for everybody," shrugs an oil-firm boss. At remote work camps, companies provide hot food, warm cabins, broadband and squash courts. All this is costly. Many firms make equipment elsewhere and truck it in, so that fewer people have to toil in the cold. Some are hoping dramatically to raise the proportion of man-hours worked off-site.

With so many bottlenecks and a volatile oil price, firms are growing cautious. Suncor Energy and Canadian Natural Resources, among others, are putting new investments on hold. "It's the uncertainty," says Marcel Coutu, the boss of Canadian Oil Sands, a firm that owns 37% of Syncrude. "No one knows when or whether those pipelines will be built." ■

Oil in America

Energy to spare

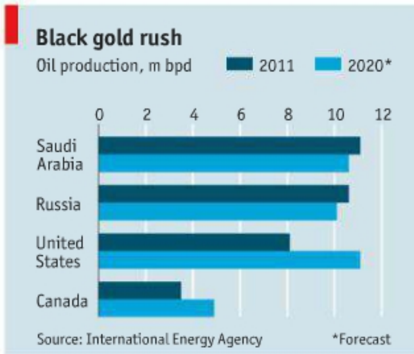
America is on track to produce all the energy it needs at home

UNTIL the late 1950s America produced all the coal, oil and natural gas that its citizens could burn. But as they grew rich and bought cars as big as whales, America began to suck in fuel from beyond its shores. It now accounts for nearly a fifth of world energy consumption. China may be the world's biggest consumer, but each American burns three and a half times as much as the average Chinese person.

Demand has more than doubled since America was last able to satisfy its energy needs from domestic sources. Nevertheless, there is a growing belief that it can do so again. During the election campaign, both presidential candidates suggested that "energy independence" was attainable. And indeed, the idea is no longer far-fetched. On November 12th the International Energy Agency (IEA), the rich world's energy club, forecast that America could become the world's largest oil producer by 2020, outstripping Saudi Arabia and Russia. It could also be more or less self-sufficient in energy by 2035.

The last time America was the world's biggest oil producer was a decade ago. Thanks to a boom in unconventional energy, America could be churning out 11.1m barrels a day (b/d) by 2020. More than one jubilant media outlet has crowed about "Saudi America".

Drilling in shale beds has made America all but self-sufficient in natural gas. A shoreline dotted with vast and expensive, but mainly idle, plants to import gas in liquid form is a testament to this rapid transformation. So much gas has been fracked that its price has plummeted, and Ameri-



can drillers have started to use the same technology to extract oil, which is still costly, from shale beds.

Even as plenty more American oil gushes out of the ground, and biofuels and natural gas fill more tanks, cars are getting more efficient. So demand is waning: by 2035 the IEA expects American oil imports to have fallen to a third of current levels—just over 3m b/d. By then the country will be exporting roughly the same amount of energy, in the form of coal and gas.

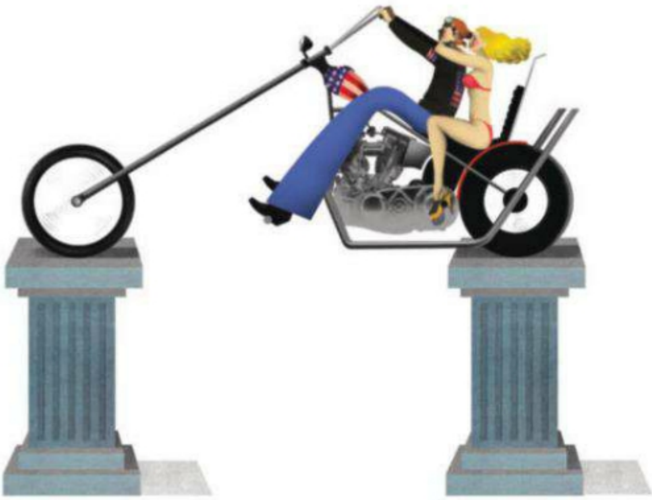
Currently America exports only a little gas. The government has granted one import terminal a licence to convert its machinery so that it can turn gas into liquid for export. Another dozen want to do the same. The White House is unsure about this. Sending gas abroad might raise prices at home; though of course it would also generate pots of money.

The IEA's forecasts look bold. But other analysts are even more optimistic. Plenty of Americans would be glad not to rely on pesky foreigners for oil and gas. But they should not imagine that they can separate themselves from world markets. Oil prices are determined by global supply and demand, and gas is going the same way. Will America be self-sufficient? Maybe. Independent? No. ■

My drill's bigger than yours

Schumpeter | Museums of Mammon

Company museums are not as dull as they sound



FOR a city that prides itself on putting its past behind it, Atlanta has rather a lot of first-rate museums. The Jimmy Carter Library and Museum celebrates Georgia's greatest president. The (Martin Luther) King Centre eulogises America's greatest civil-rights leader. And the World of Coca-Cola worships the world's greatest carbonated drink.

When Schumpeter visited Atlanta, the World of Coca-Cola was by far the most popular of the three. It attracted a cross-section of America (minus the Ivy League): veterans criss-crossing the country in RVs, children on school trips, families on holiday, all adding up to about 2,500 visitors a day or 1m a year. The World of Coca-Cola tells the story of Coke's rise from "the ideal brain tonic" for headaches and exhaustion, sold exclusively in pharmacies, to the world's most powerful brand. It contains thousands of Coca-Cola-themed objects, from Haddon Sundlom's pictures of Santa Claus clutching a glass of festive fizz to a child's piggy bank that dispenses a tiny Coke when you deposit a coin.

The World of Coca-Cola can be surprisingly informative—Schumpeter learned that Coke was clear during the first world war and that the country that swigs the most Coke per head is Mexico. It can also be frustratingly evasive. The story of the New Coke debacle is confined to one video. The rivalry with Pepsi is glossed over: "We don't mention the P-word." The tour ends with a Coca-Cola orgy: a chance to sample Coke's 64 favourite products from around the world while listening to "I'd like to buy the world a Coke".

The world's most discerning travellers have always included corporate museums in their itineraries. The SPAM Museum in Austin, Minnesota, is the Guggenheim of pork products. The Kohler Design Centre in Kohler, Wisconsin, is the Frick of bathroom fixtures. The Cumberland Pencil Company's museum in Keswick, England, is the British Museum of old pencils. But now company museums are going mainstream.

A corporate museum is a shrewd way to bolster a brand. If it's good, people will actually pay to hear your story. So companies have been transforming stodgy old-fashioned museums—collections of company artefacts and documents—into corporate theme parks. And they have started using their histories to enrich their brands and deepen their relationships with customers.

Harley-Davidson offers a fine example. Its museum in Milwaukee contains more than 450 motorbikes: from the first one it produced (which is encased in glass and bathed in a halo of light) to the most recent creations. The museum displays cultural icons, such as Elvis Presley's bike and a copy of the one that Peter Fonda rode in "Easy Rider" (the theme tune, "Born to Be Wild", often fills the air). The museum spills into the car park: there is room for 1,000 bikers to park their hogs.

John Deere reopened its museum in Moline, Illinois, earlier this year after a big renovation. Visitors can try their hand at driving some of the company's mighty machines—albeit on simulators. They can also learn about the history of tractors. The museum shows how various breakthroughs have revolutionised productivity, including contraptions that were tried but later rejected. It also airs surprisingly moving videos of farmers talking about what their machines have meant to them.

Among the firms that use their museums most effectively as a marketing tool are the German carmakers. BMW has a giant cauldron-shaped museum right next to its headquarters in Munich. It traces the company's origins making aircraft engines and its expansion into motorbikes and then cars. The museum is linked by a walkway to the futuristic BMW Welt (World), where punters can have lunch and buy cars. Mercedes-Benz has a similar arrangement in Stuttgart. It has also built a satellite Mercedes-Benz World in Weybridge, Surrey, that displays past and present models, and offers driving courses on an old motor-racing circuit. Even children are allowed to drive around the track, so long as their feet reach the pedals.

Memory banks

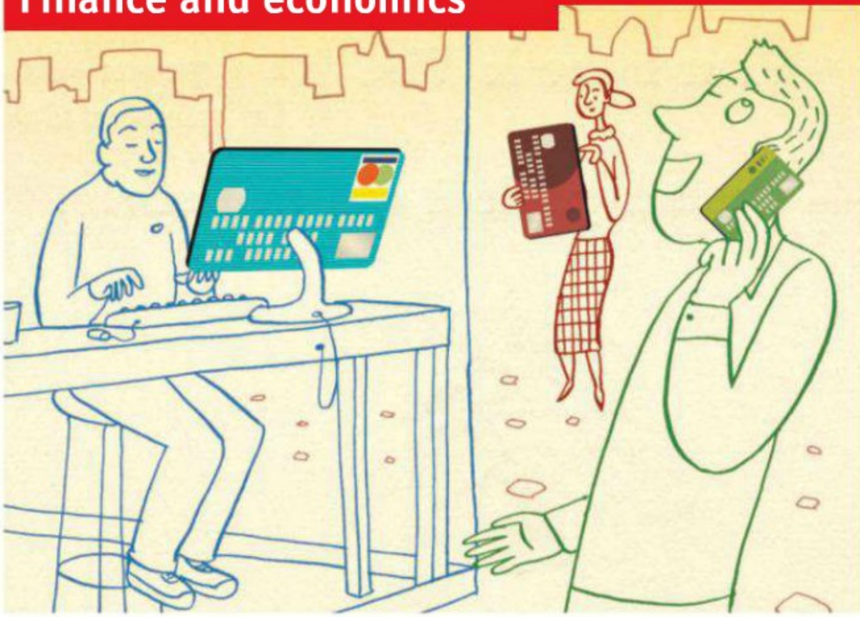
Various banks have also grasped the value of history. It conveys a sense of solidity. Wells Fargo has nine museums across the American West, full of stagecoaches and gold-digging paraphernalia. It also lends replica stagecoaches to festivals. HSBC has a history wall at its London headquarters with 3,743 images drawn from its archives and arranged in chronological order.

Company museums are not just for cementing bonds with customers. Hershey uses its Chocolate World museum to teach its employees about corporate culture. Harley-Davidson uses its collection of old bikes to inspire its designers. Coca-Cola ends its display with a taste of the future: a small machine, named the Freestyle, that can dispense 100 different Coca-Cola products. Mercedes ends it with a look at the road to emission-free mobility.

Serious historians frown on corporate museums. They are seldom objective: even before the brand managers got hold of them, they had a tendency to glorify their subjects. And they are unreliable preservers of the past. Tupperware has ditched its museum of food containers in Kissimmee, Florida (though it maintains something similar in Orlando). Companies that go under typically take their museums with them: the Waterford Wedgwood Potteries, for example, was ordered to sell its remarkable collection after the company went bankrupt in 2009.

However, the rise of corporate museums says something interesting about collective memory. Ordinary people have grasped much better than professional historians that great companies and their products often affect their lives far more intimately than the politicians who are celebrated in more conventional museums. ■

Economist.com/blogs/schumpeter



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Credit-card companies

War of the virtual wallets

SAN FRANCISCO

Visa, MasterCard and other big payment networks need not be victims in the shift towards digital cash if they play their cards right

ANOTHER milestone on the journey towards digital cash was passed on November 13th. That date marked the emergence from beta-testing in America of v.me, a "digital wallet" that holds multiple payment cards in a virtual repository. Instead of providing their personal details and card numbers to pay for stuff online, customers just enter a username and a password. The service is provided by Visa, a giant card-payment network whose headquarters is in the heart of Silicon Valley, close to a host of technology firms which would love to get their hands on a chunk of the global payments business.

Card companies make a tempting target. Some, such as Visa, MasterCard and China's UnionPay, manage credit, debit and prepaid cards issued by their members; others, such as American Express, pump out their own plastic. The amounts of credit and cash they process are mind-boggling. Last year some $6.7 trillion was channelled through credit cards managed by the networks, according to the *Nilson Report*, an industry newsletter. Throw in debit and prepaid cards and the number exceeds $15 trillion (see chart).

Such sums explain why so many firms, from telecoms companies to retailers and start-ups such as Square, a new payments firm based in San Francisco, are determined to transform the way people pay for things. Some upstarts foresee a post-plastic world that will put a dent in card giants' earnings. But the payment networks are not going to let that happen without a fight.

In the short term new technology is actually boosting usage of plastic. Smartphone apps often require users to enter their card details to pay for services. Firms such as Square and PayPal have developed tiny card readers that plug into smartphones and allow small traders using their software to accept payments cheaply. Ed McLaughlin, who oversees emerging payments technologies at MasterCard, reckons such developments have added 1.2m new businesses over the past 12 months to the card firms' list of merchants.

But even if plastic cards eventually go the way of vinyl records, card networks should still prosper because they too are investing heavily in new technology and have several built-in advantages. Visa is betting its member banks can help it to narrow the gap with rivals like PayPal, for instance, which is part of eBay and has grown to 117m active users thanks in part to its use on the auction site. Over 50 financial institutions are supporting the launch of v.me, which accepts non-Visa cards in its wallet, too. MasterCard and others are also touting digital wallets, some of which can hold digital coupons and tickets as well as card details.

Before long all of these wallets are likely to end up on mobile phones, which can be used to buy things in stores and other places. This is where firms such as Square, which has developed its own elegant and easy-to-use mobile wallet, and Google have been focusing plenty of energy. Jennifer Schulz, Visa's global head of e-commerce, predicts there will be a shake-out that leaves only a few wallet providers standing. Thanks to their trusted brands, big budgets and payments savvy, one or more card companies will be among them.

Card networks are also taking stakes in innovative firms to keep an eye on potentially disruptive technologies. Visa owns part of Square, which recently struck a deal with Starbucks to make its mobile-payment service available in 7,000 of the coffee chain's outlets in America. Visa has also invested in Monitise, a mobile-banking specialist. American Express, for its part, has set up a $100m digital-commerce fund, one of whose investments is in iZettle, a Square-like firm based in Sweden.

So far few have tried to create new payments systems from scratch. Those that have toyed with the idea, such as ISIS, a consortium of telecoms companies in America, have concluded it is far too costly and painful to deal with regulators, set up anti-fraud systems and so forth. (Last year all four big US card networks joined ISIS.) Fears about the security of new-fangled ▸▸

payment systems also play into the hands of established card firms.

Still, they cannot relax. Bryan Keane, an analyst at Deutsche Bank, points out that rival digital wallets could promote alternatives to credit and debit cards, including stored-value cards and direct bank-account-to-bank-account payments. Big retailers in America have clubbed together to create their own digital wallet and are likely to prompt users to choose the payment options that are cheapest for the chains, by offering them incentives like coupons.

Jack Dorsey, the boss of Square and a co-founder of Twitter, agrees that digital wallets will make the trade-offs between various payment options clearer to consumers and reckons this will force card networks to up their game. "They had a major innovation 60 years ago [when the charge card was created]," he says, "and there have been very, very few innovations since." Some in the payments world might quibble with that but one thing they can all agree on is that the spread of mobile payments will bring many more customers. MasterCard's Mr McLaughlin claims that 85% of commerce still involves cash and cheques. As mobile purchases take off, more of this activity will move online.

The biggest prize of all lies in emerging markets, where a lack of financial infrastructure is hastening the rise of phone-based payments systems such as M-Pesa, which serves Kenya and several other markets. Visa has snapped up Fundamo, which specialises in payment services for the unbanked and underbanked in emerging markets; MasterCard has set up a joint venture called Wanda with Telefónica, a Spanish telecoms firm, which aims to boost mobile payments across Latin America. The payments world is changing fast but the card firms are not about to let rivals swipe their business. ■

Buttonwood | Converging world

Countries' fiscal policies are becoming more similar

ALL around the developed world politicians are struggling to figure out the best way of balancing their budgets, at least over the medium term. But is it easier to get spending down or taxes up?

The charts show the recent record on tax and spending for America, the euro zone and the OECD as a whole. The spending numbers are slightly more variable and consistently higher than the tax take. Both tax and spending are subject to cyclical effects. Spending has a cyclical component because of the cost of unemployment benefit as well as the use of deliberate Keynesian stimulus. On the tax side revenue from corporate profits and capital gains falls sharply during downturns, although consumption taxes are more stable.

What is striking is the narrow range within which the tax take has moved. Since 1994 euro-zone taxes have not been below 44.6% or above 46.6% of GDP. In America the total tax take has been between 30% and 35% of GDP since 1970. Such stability may be partly due to efforts by reforming governments of the 1980s and 1990s to reduce taxes. But it raises the question of whether there might be some upper limit to the amount of tax governments can grab.

In a globalised economy people and capital can move to escape high-tax regimes—France's new 75% top income-tax rate comes to mind—or base their operations in low-tax places such as Ireland. Tax competition is clearly not the only thing at work; otherwise it would not be possible for the euro zone to have a tax take 14 percentage points higher than America's. The big difference between the two is consumption taxes; Europe has hefty value-added tax and America has no national sales tax. Europeans are unlikely to migrate to escape VAT.

Flat taxes

Public finances, % of GDP

Source: OECD *Forecast

Nevertheless, there are signs of a narrowing in the spread between the highest- and lowest-taxing jurisdictions. In 1994 the five highest tax regimes in the OECD had an average tax take of 55.7%; this year, it is 53.6%. The five lowest tax regimes in 1994 had an average take of 30.5%; now it is 33%.

Countries do not "compete" on government spending. But if there is a tax constraint on policy you would expect that high-spending governments would eventually have to cut their coat to meet their cloth. The six highest-spending countries of 1994 (France and Norway were tied for fifth place) were spending 59.4% of GDP; this year they are spending just 52.8%. France is the only one of the group with a higher tax take than in 1994.

By contrast low-spending (and taxing) governments have faced no such constraint. The five lowest spenders of 1994 have seen their average outlays rise from 32.7% to 36.5% of GDP. In short, fiscal policies are converging rather than diverging.

Much economic analysis of tax regimes focuses on the optimal system: the maximum marginal rate, the balance between taxes on consumption and income, the need to reduce loopholes and so on. When it comes to discussing the overall tax take from GDP the debate tends to be ideological. Conservatives favour a smaller state on grounds of both liberty and economic efficiency. By destroying the incentives to work, welfare states weaken growth, they say.

In contrast Peter Lindert of the University of California, Davis claims that historical analysis suggests no link between high social spending and growth rates. A rough-and-ready look at the past 18 years certainly provides no clear pattern. The low spenders of 1994 included Japan and Switzerland, neither of which have grown very rapidly since. The low-spending group also included South Korea, where GDP has more than doubled since 1994. In that time, however, the country has also seen the largest rise in spending relative to GDP of all OECD nations.

A reasonable guess is that nations will continue to converge in their fiscal policies. High-spending Europe is undergoing austerity; lower-spending countries are grappling with the costs of an ageing population. In America, as national politicians bicker, state and local authorities face huge pension-fund deficits; higher taxes are likely to be part of the answer.

Economist.com/blogs/buttonwood

Jefferies and Leucadia

There's the beef

NEW YORK

The strange combination of a conglomerate and an investment bank

IT IS a deal so odd-looking that no banker would dare pitch it: tie a conglomerate with large interests in meat processing and mining to an investment bank, then install the bank's management at the top of the new enterprise. But that is the combination announced on November 12th by Jefferies, a rare financial success story, and Leucadia National, a secretive company with a history of lucrative contrarian bets.

The two know each other well. Leucadia has owned a stake in Jefferies since 2008. Its two most senior executives, Ian Cumming and Joseph Steinberg, sit on Jefferies's board. But the history of industrial firms buying investment banks is limited. In the 1980s General Electric bought Kidder Peabody and Xerox bought Furman Selz; neither deal worked out particularly well. In the case of Jefferies and Leucadia there are no obvious economies of scale.

The one area where there will be cost savings is the executive office. Mr Cumming, Leucadia's 71-year-old chairman, and Mr Steinberg, its 68-year-old president, will remain on the board but surrender operational control. Their investment track record will be hard to match. Two Jefferies executives, Richard Handler and Brian Friedman, will become, respectively, chief executive and president of the combined venture while maintaining control at Jefferies. The bank's recent performance has been excellent but their operating responsibilities will now greatly expand.

That may explain the lukewarm reaction. The $3.6 billion all-stock offer was at a premium to Jefferies's share price, which rose by 14% on the day of the announcement. Leucadia's dropped, lopping off much of the firms' combined appreciation.

Supporters can point to Leucadia's success in pulling off non-obvious deals, most recently by quadrupling its money in a 2006 wager on Fortescue, an Australian miner buoyed by Chinese demand for commodities. The resulting flood of cash on Leucadia's balance-sheet should provide reassuring ballast for its new investment-bank subsidiary, which suffered a brief panic in 2011 after the collapse of MF Global, a broker. Leucadia's deferred-tax assets, a benefit that reduces future tax liabilities, will add to the stockpile.

The cash will also allow Jefferies to capitalise on tough times in the industry by making acquisitions, of people if not whole institutions. The past two weeks have been brutal for American financial firms. Keefe Bruyette & Woods, a boutique bank, agreed to be absorbed by Stifel Financial; Rochdale Securities is looking for help after suffering losses in an unauthorised trade. Big banks' shares fell sharply after the presidential election as hopes of a rollback of regulatory reforms ebbed.

Making the combined company's balance-sheet stronger does not necessarily mean making it ever larger. The firm will have assets of $42 billion, well below the $50 billion level set by the Treasury for designation as a systemically important financial institution. That label provides some big benefits (like access to the Federal Reserve's discount window in a crisis) but at the cost of additional regulation.

Jefferies has avoided activities that create possible systemic risks, like clearing, routinely lending to financial firms or doing much directly with individuals. It has, in short, tried to be an entity that would not be missed if it disappeared. If only for beefing up its own resources rather than relying on the government's safety net, the Leucadia deal is worthy of applause. ■

Private equity in America

An end to the carry on

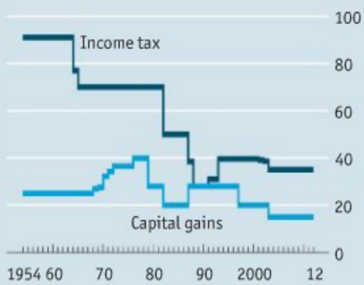
Buy-out firms face the prospect of a bigger tax bill

AFTER Mitt Romney's defeat in the presidential election, Bain Capital, the private-equity firm he ran before taking up politics, wrote to its investors thanking them for their patience in the face of "political hyperbole and distortion". It is not just Bain that will feel relief the election has passed: the discreet private-equity industry has not enjoyed the limelight. But the fallout is not over. A renewed look at the favourable treatment the industry has received from the taxman is surely coming.

Under existing "carried interest" rules, private-equity firms' profits are taxed at the rate imposed on capital gains, currently 15%. Mr Romney's own tax returns, which showed he paid 14.1% in 2011, raised eyebrows during the campaign: workers typically pay a top marginal tax rate of 35% on their income. The Obama campaign characterised carried interest as a "trick"; the president wants to close the loophole.

Spot the difference

United States, top federal marginal tax rate, %



Sources: US Department of the Treasury; Tax Foundation

The industry argues that its executives should be treated as entrepreneurs. The business of buying companies cheaply and selling them on (if all goes well) for a profit generates capital gains. It involves the sort of risk-taking that policymakers seek to encourage by differentiating between income and capital-gains tax rates (see chart). Hedge funds and other investors also generate capital gains but usually don't hold on to assets long enough to qualify for preferential tax treatment.

Critics counter that private-equity executives are more like investment bankers. Yes, their deals generate capital gains but that does not entitle them to the lower rate. That is because the firms themselves are not the true risk-takers: typically 98% of money used to fund buy-outs comes from outside investors. The 20% of profits that Bain Capital and its peers typically get to keep if they hit their targets (on top of the 2% of assets they take each year as a management fee) is akin to a banker's bonus, which is taxable at the higher rate. "If you put in capital, you get capital gains. If you put in labour, you pay income taxes," says Michael Graetz, a professor of tax law at Columbia University.

Many in the industry privately admit the tax treatment to date has been generous. Others do so publicly, including Marc Andreessen, a prominent venture capitalist, and Joe Dear, the chief investment officer at CalPERS, a Californian state pension fund that is among private equity's biggest investors. That makes the treatment of carried interest look like an easy win in the battle to right the public finances: Congress estimates $2 billion could be brought in annually, most of it from the super-rich.

Lobbyists for the industry warn that investment could fall by more than ten times that amount (and that other sectors that use partnership structures, such as mining or real estate, could inadvertently be hit). That seems implausible. Only a third of private-equity profits comes from carried interest, according to one estimate, with the guaranteed annual management fee—already taxed at 35%—making up the rest. Private equity is alive and well in countries that treat carried interest as income.

There are many reasons to laud the way private equity is structured: unlike other parts of high finance, private-equity executives really hit the jackpot only if they generate sizeable long-term returns for their investors. Firms in the industry can, and do, fail. But a change in the way private equity pays its taxes is long overdue. ■

Europe's banking union

Made in Brussels

The euro zone needs a banking union, but this isn't it

THE tale of the euro, from inception to crisis, has been one of compromises that keep the show on the road but have not yet managed to build a genuinely stable currency union. So it is with Europe's tentative steps to build a banking union, a project that seems as likely to weaken faith in the single currency as restore it.

The case for a banking union is a strong one. Weak banks in Spain and Ireland have wrecked their countries' public finances. In countries such as Italy and Greece governments with shaky finances are leaning on their banks to buy government bonds. The best way to sever this dangerous link between banks and governments is to wrest responsibility for supervising and, if need be, resolving banks away from national governments. Frantic negotiations are now taking place ahead of a meeting in Brussels in early December that is meant to agree upon a banking union.

The main element will be to appoint the European Central Bank (ECB) as the main banking supervisor in Europe. If its remit covered all banks in Europe, then in principle it would be a step forward. That would give assurance to Germany (or anyone else who might have to contribute to a bail-out) that small banks in Spain or Italy would not be allowed to load up on dud assets. Yet it is Germany that argues most vigorously that the ECB should supervise only a handful of big cross-border banks. Its coyness has much to do with its fear of what supervisors might say about its own *Landesbanken*, wholesale banks with a history of duff judgments. "The first call the new supervisor would make would be to Germany to tell it to recapitalise its banks," says the boss of a large French bank, with a mischievous grin.

Even if the ECB is put in charge of all of Europe's banks, however, dealing with a crisis will be nigh-on impossible. The current plan provides for neither a common "resolution fund" to mop up after failed banks nor a shared deposit-insurance fund to prevent bank runs. Both of these have been pulled off the agenda because of the daunting sums of money involved. "The numbers are simply too big," says one person involved in the talks. "If it were pushed it would blow up the whole discussion [about banking union] because it would scare the creditor countries."

Even a modest deposit-insurance fund could cost more than €100 billion ($127 billion). A pre-financed resolution fund big enough to clean up the mess from the failure of even a single medium-sized bank would probably have to be just as large. The cost of dealing with a systemic crisis would be far bigger. Sweden's taxpayers ended up paying about 3.6% of GDP to clean up their banking system after its crisis in the early 1990s, which as a proportion of euro-zone GDP would be €340 billion.

Under the current proposals the ECB will be responsible for overseeing banks but may not actually be given the power to order failing banks to raise capital or be shut down. With such ill-defined powers the ECB may have to use brinkmanship to enforce its writ. "If a local supervisor shows them two fingers there isn't much they can do," says one senior regulatory lawyer. "There is only really one sanction…If the ECB cuts off access to euro liquidity then the bank is dead." That is a similar position to the one it is in now. Because its decisions could impose costs on governments, some of which may be in no position to assume them, the ECB may be reluctant to use these extreme powers.

The separation of authority for overseeing banks from the responsibility for cleaning up after them raises a second problem. If the ECB allows a bank to accumulate risk against the advice of a domestic supervisor, its legitimacy would be deeply damaged if the bank then had to be bailed out. This is not merely a theoretical risk. At the moment zealous regulators in several European countries are trapping pools of liquidity held by branches and subsidiaries of banks that are based in other European countries. One example is Italy's UniCredit, which is understood to be unable freely to use deposits gathered by its German subsidiary, HypoVereinsbank. Supervisors in France and Britain are both also understood to be forcing foreign banks to hold large pools of liquidity.

Senior policymakers see this as an impediment to the flow of credit and a barrier to the transmission of monetary policy in the euro area. Lifting this blockage would be "one of the first credibility tests of the single supervisory mechanism", says one person close to the talks.

Disjointed and several

The wrangle over deposit insurance is no less intense than the one over resolution funding. On November 7th Mario Draghi, the president of the ECB, told German bankers that banking union need not "imply the pooling of deposit guarantee schemes", saying these could remain national. Recent plans for a single fund have now been dropped. Officials in Brussels are looking for a backdoor by proposing rules that may force national funds to "lend" money to one another. A related proposal would oblige national deposit-guarantee schemes to insure deposits gathered by foreign banks in the schemes' countries. That would only widen the gap between the power to supervise a bank and responsibility for paying for its failure.

The survival of the euro zone may well rest on its ability to forge a banking union. The difficulties of marrying the interests of euro-zone members and those of other countries, like Britain, which are not in the euro but could be outmuscled within Europe by a cohesive ECB-led bloc are hard enough. Shortcuts that fudge questions of accountability and dodge a genuine pooling of risk make matters even worse. ■

Development aid

It doesn't take a village

The perverse effects of local aid

CHANNELLING development aid directly to local decision-makers sounds like a good plan. Empowering local groups like community clubs and school boards means decisions can reflect actual needs on the ground. It should mean fewer bureaucratic hands in the pot, too. But a new report* by two World Bank economists warns against relying on decisions made at the most local level of government. Entrenched elites, bribery and fraud are as much of a problem in village life as they are in big emerging-market bureaucracies.

That warning will come as a shock to many. The idea that management of natural resources and services like health and education might be improved if locally controlled has deep roots in development, say Ghazala Mansuri and Vijayendra Rao, the report's authors. Where local participation does not happen organically, in groups that represent parents, women or workers, development aid often tries to nudge such efforts along by "inducing" it.

Projects designed to build local governance or distribute funds through local bodies represent close to 30% ($85 billion) of the World Bank's development resources over the past decade. Other aid providers, including the United Nations and Britain's Department for International Development, have trodden the same path.

But the evidence in support of induced local participation falls far short of the theory, Ms Mansuri and Mr Rao's exhaustive review shows. The first problem is corruption. A study based in Madagascar, for example, found that central government was actually a relatively safe steward of development cash, with more of it siphoned off at local-government levels.

The scale of theft and fraud is shocking. In one education project in Uganda, local politicians stole 87% of the aid money. The remainder was divvied up in a regressive way: better-off communities got more than the poorest. In Indonesia a decentralised subsidised-rice programme ended up with a fifth of the rice going missing. Much of the rice that didn't disappear went to better-off families that were not eligible to get it. Overall, the scheme lowered welfare.

Other projects provide cash to help local communities manage natural resources like rivers and forests. Getting this right is vital since the poorest often make a living from such resources. In addition forests double up as a sort of safety net, providing food, shelter and fuel in the toughest times. But in Tanzania a local forestry taxation and licensing system ended up raising barriers to entry for the poorest timber and charcoal producers, making them more dependent on town-based traders and powerful village leaders.

Projects that boost local oversight of services can work. When local Kenyan communities started monitoring schools, teachers began to show up on time and students did better. But there are bad examples, too. In Argentina school decentralisation pushed up students' test scores on average but the benefits were confined to pupils in the richer areas, with poor kids seeing their grades decline. The aid may have undermined the worst-off.

The report paints a grim picture of how some groups are undermined by local elites. The most marginalised are often minority ethnic groups and women. Those that have little access to news (because they live far away, or cannot read) fare worst. Even so, Ms Mansuri and Mr Rao are optimistic: they reckon that by laying bare failings things can start to improve. Their new boss, Jim Yong Kim, has promised a World Bank focused on delivery and on hard evidence. Setting out a strategy to deal with the findings in this report will be an early test of that pledge. ■

* "Localising Development: Does Participation Work?", http://econ.worldbank.org/localizingdevelopment

China's economic performance

The paramountest leader

HONG KONG

The records of three leaders compared

THIS week Hu Jintao, China's president, stepped down as leader of the country's Communist Party. His economic record would be the envy of most leaders elsewhere in the world, but how does it compare with that of his predecessors? He inherited an economy that had grown by 9.6% a year on average during Jiang Zemin's time in office and almost as quickly during Deng Xiaoping's years in charge. Rather than try to match that pace of expansion, Mr Hu promised a more balanced path of development in pursuit of a more "harmonious" society.

As it turned out, growth was even faster under Mr Hu, at 10.7%, than it had been under his predecessors. Growth has slowed to less than 8% this year. But that is still fast enough to meet Mr Hu's target, announced this month, of doubling income per person from 2010 to 2020.

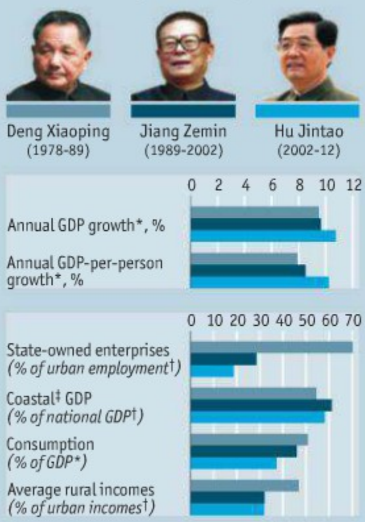
Has this hectic growth also been more harmonious? China's development has traditionally favoured the city over the countryside and the coast over inland regions. By the time Mr Hu assumed office, China's coastal provinces accounted for 61% of the country's economic output. Heavy investment in inland provinces has helped to arrest that trend: the coast's share of GDP was 58.5% last year. Urban incomes also outpaced rural incomes under Deng's rule and in the latter half of Mr Jiang's reign. By 2008 rural incomes averaged less than 30% of urban disposable incomes. Since then, according to official figures, rural incomes have regained some ground.

Mr Hu also sought more balanced growth. But his efforts to expand the role of household consumption failed. Its share of GDP averaged an astonishingly low 37% from 2003 to 2011, compared with 46% under Mr Jiang. Mr Hu can say that the consumption ratio rose in 2011 and in the first nine months of 2012.

Consumption has lagged partly because China's capital-intensive, monopolistic state-owned enterprises (SOEs) have raked in profits rather than driving down prices or bidding up wages. The SOEs shed tens of millions of jobs under Mr Jiang, but their share of urban employment has stabilised on Mr Hu's watch. In his speech at the party congress, Mr Hu described public ownership as the "mainstay of the economy". Unfortunately that sentiment is not in harmony with balanced growth.

Hu's the best?

China's economic performance by leader



Sources: CEIC; National Bureau of Statistics; The Economist

*Term average
†Last/latest year of term
‡Including Beijing

Interdealer brokers

At the sharp end

The firms that connect buyers and sellers in wholesale markets are under the cosh

WITH their boozy client dinners, big bonuses and foul-mouthed traders, interdealer brokers are stalwarts of a financial order that is in retreat. As their name suggests, they exist to broker trades between wholesale-market participants, most of which are banks, and they deal in everything from Treasury bonds to over-the-counter (OTC) derivatives.

The brokers serve a number of purposes. For OTC derivatives, for example, liquidity is episodic. Interdealer brokers perform a price-discovery function, helping banks get a clearer picture of where the instruments are trading. In the predatory world of big banks, they provide another valuable tool: anonymity. If a large bank held a massive lossmaking position in interest-rate swaps, for example, a broker might help them gradually sell their position with other banks. That should help prevent other firms from discovering the bank's position and trading against it.

In effect, the role of an interdealer broker closely resembles that of an exchange. Like exchanges, they have trading floors, most of which are noisy and boisterous places. Although an increasing amount of business is electronic, much of it is still transacted over the phone. Brokers are organised by product line and each has a direct telephone link to one or several of the firm's clients. As orders come in they may be shouted across the desk to colleagues, in the hope of finding another client to take the other side of the trade. It takes a sharp individual to succeed, says one industry veteran: "Some of these guys come across as unvarnished but they have to have the ability to take in a lot of information in a fast-paced environment, probably while dealing with a hangover from entertaining clients the night before."

For those who can keep up the rewards are high. Brokers charge banks a commission on every trade, and individual brokers can expect to keep around 60% of the commissions they earn. That can add up to millions a year for the best people.

Five firms dominate the landscape. The biggest of these is London-based Icap, a voice-and-electronic broker that is headed by Michael Spencer, a former treasurer of Britain's Conservative Party. Next in the pecking order is Tullett Prebon, another London-based outfit that has a similar strength in voice brokerage but lacks Icap's electronic clout. Its chief executive is Terry Smith, an outspoken former stock analyst who rose from humble roots in London's East End. Lagging behind the two main players are Tradition, a Swiss firm, and New York-based BGC Partners, a company spun out of Cantor Fitzgerald in 2004. GFI Group, which is also based in New York, brings up the rear and specialises in more complex products such as foreign-exchange options and credit derivatives.

The fates of all five are closely tied to those of the banks. Before the crisis, that was a blessing. As banks grew their balance-sheets, volumes grew at the same time, says Arnauld Giblat, an analyst at UBS. No longer. Now banks are slimming, brokers are also on an enforced diet. On November 14th Icap revealed that its first-half profits dipped sharply compared with the same period of 2011 due to poor economic conditions, the euro-zone crisis and a retreat in trading by banks.

Another threat is regulatory reform in the derivatives market. As part of a G20 agreement in 2009 supervisors want most "standardised" OTC derivatives to be centrally cleared. Clearing requires market participants to post margin against their trades, raising the cost of using OTC derivatives. There are fears this could drive many firms towards using exchange-listed futures instead, denting brokers' volumes.

Furthermore, the G20 calls for standardised OTC derivatives to be executed using electronic platforms. Although similar rules are on the way elsewhere America has gone furthest down this road. That will require brokers to transform themselves into transparent and more closely regulated trading venues, with all the expenditure on technology, reporting and compliance that entails. It also means more competition from other firms that want to set up their own platforms.

Breaking back

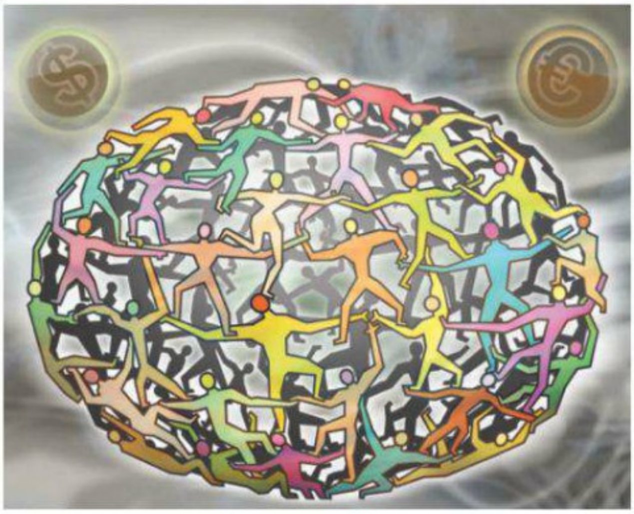
The brokers are responding. They are increasing their investment in markets less likely to be hit by regulatory reform: BGC Partners has been pushing harder into real-estate brokerage, for example. In addition, the brokers are diversifying into areas like post-trade processing, which will actively benefit from new rules. Icap has been the most successful in this regard, buying companies like TriOptima, a firm that helps market participants bring down the size of unwieldy derivatives books by identifying offsetting trades. And brokers are also cutting costs, which means laying off staff.

Such moves have hurt morale but there are some reasons to be cheerful. Illiquid markets will always need brokers, argues Jillian Miller of BMO Capital Markets. Compared with trades conducted over the phone, she points out, the commissions paid to individual brokers for electronic trades are much lower. If more trading were conducted electronically due to market reforms, brokers should see their profit margins increase. And even if trading by banks is set for a permanent decline, brokers argue they could do more business with big hedge funds and others.

Whether there will be enough business to sustain the five big firms is an open question, however. "In time, we would expect there to be further consolidation," says Mr Giblat. Such pressures suggest the client dinners may become less boozy, but the language will be as ripe as ever. ■

Free exchange | Border follies

Liberalising migration could deliver a huge boost to global output



IN BAD economic times the temptation to bash immigration is overwhelming. "Get the stench out of Greece," runs a slogan of Golden Dawn, an increasingly popular anti-immigrant party there. David Cameron has pledged to more than halve annual net migration into Britain by 2015. In America Republicans are wondering how much anti-immigration rhetoric contributed to Mitt Romney's defeat in the presidential election. A change of political tune is badly needed. Evidence suggests that increased flows of people across borders could ignite global growth.

The economic case for migration is similar to that for free trade. Trade benefits countries by letting workers specialise in activities in which they are relatively more productive, raising output. And the larger market created by trade spreads the fixed costs of innovation more thinly, encouraging the development of new goods and ideas. Governments began the long march towards trade liberalisation after grasping that its upsides outweigh its costs, leaving a surplus large enough to compensate the losers.

Immigration is an afterthought, in both practice and theory. In traditional trade models wages converge across trading partners with similar technologies even without migration, a phenomenon winningly branded "factor-price equalisation". Sadly, factor-price equalisation is a real-world rarity. As of 2000, for instance, a worker in Mexico earned a wage 40% that of a Mexican-born worker of similar education and experience working in America.

Most of this wage gap is down to productivity differences, stemming from disparities in the quality of infrastructure, institutions and skills. An individual worker, however talented, cannot hope to replicate the fertile environment of a rich economy all on his own. But transplanting a worker into rich soil can supercharge his productivity. A Mexican worker earns more in the United States than in Mexico because he can produce more, thanks to the quality of US technology and institutions.

Millions may move from poor world to rich without bidding down wages in the rich country relative to the developing one. True, a rapid burst of immigration might temporarily reduce wages. But if the pace of movement is slow enough to allow investment to adjust, borders could open without any wage dislocation in either origin or destination economies. Migrants themselves would benefit handsomely, however. In a new paper* John Kennan of the University of Wisconsin-Madison estimates that opening borders could raise the average wage of workers from developing countries by $10,100 a year, or more than 100%, thanks to the large rise in the incomes of those opting to migrate.

Those bigger incomes should swell global GDP. In a recent report Sharun Mukand of the University of Warwick calculates the effect of movement by half of the developing world's workforce to the rich world. Such a vast migration could never happen in practice, of course, but as a thought exercise it is instructive. If migration closes a quarter of the migrants' productivity gap with the rich world, their average income would rise by $7,000. That would be enough to raise global output by 30%, or about $21 trillion. Other studies find even bigger effects. A 2007 paper by Paul Klein, now at Simon Fraser University, and Gustavo Ventura, now at Arizona State University, reckons that full labour mobility could raise global output by up to 122%. Such gains swamp the benefits of eliminating remaining barriers to trade, which amount to just 1.8-2.8% of GDP, reckons Mr Mukand.

Even a modest (and more practical) easing of restrictions could be very rewarding. Lant Pritchett of Harvard University estimates that just a 3% rise in the rich-world labour force through migration would yield annual benefits bigger than those from eliminating remaining trade barriers. The incorporation of women into the rich-world workforce provides an analogy: this expanded the labour supply and the scope for specialisation without displacing the "native" male workforce.

Rich-world residents nonetheless worry that migrants will gain at their expense. Yet in a survey of research on the topic Francine Blau and Lawrence Kahn of Cornell University find that few studies turn up a negative impact on native wages. In a recent paper on western Europe Francesco D'Amuri of the Italian central bank and Giovanni Peri of the University of California, Davis find that immigration encourages natives to take more complex work. Such "job upgrades" are responsible for a 0.6% increase in native wages for each doubling in immigrant labour-force share. Where immigration disadvantages subsets of the population, Gordon Hanson of the University of California, San Diego reckons that charging an entry fee to migrants or their employers could help pay for training or benefits for those who lose out.

A frosty welcome

Advanced economies may also fret for their budgets. In a survey of fiscal studies Sari Pekkala Kerr of Wellesley College and William Kerr of Harvard University find that immigrants may sometimes use social services more intensely than natives. Yet it is hard to argue that immigrants are a systematic drain on the public purse. Some newcomers contribute more in tax than they receive in services, offsetting much of the drag from those who are net recipients of public benefits.

Others worry that emigration by talented people may hurt the economies they leave behind. But the possibility of migration creates incentives for people in emerging markets to invest in education, including among those who opt to stay put. Immigration generates remittance flows back home; informal links facilitate cross-country trade and investment. If policymakers can see past their fear of the foreign, the dividends could be huge. ■

* Studies cited in this article can be found at www.economist.com/migration12

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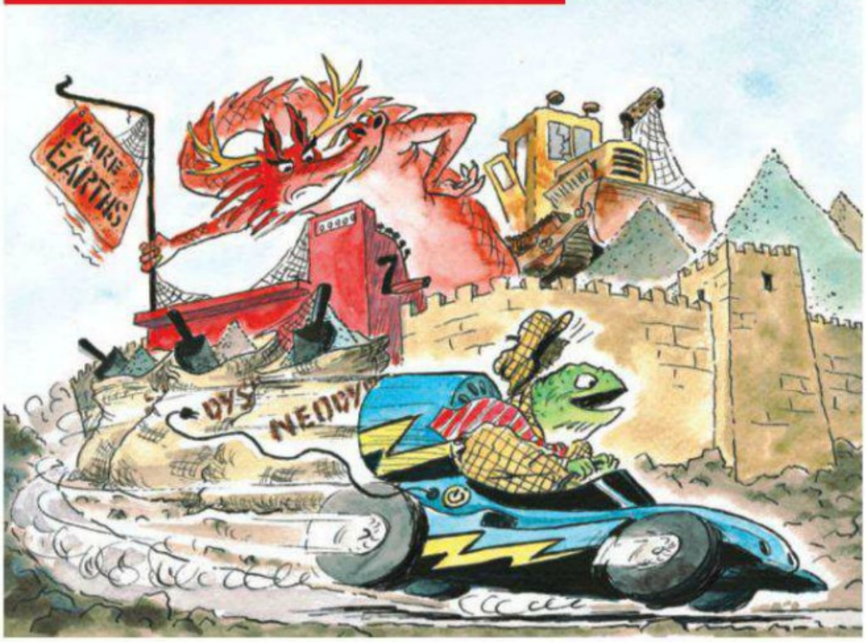

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Electric motors

Reluctant heroes

An electric motor that does not need expensive rare-earth magnets

DYSPROSIUM and neodymium are not exactly the best-known elements in the periodic table, but for makers of high-end electric motors they have become vital. Both are strongly magnetic and thus crucial to the construction of powerful motors of the sort used, for example, in electric cars. Unfortunately, they lurk in the part of the table known as the rare-earth metals and, as that name suggests, workable deposits of them are scarce. At the moment, the main source of supply is in China, whose government has used its near-monopoly to restrict availability and push up the price. So there is a lot of interest in inventing motors that can do without them. And several groups of researchers think they have come up with one.

The device in question is known as a switched reluctance motor. The idea behind it is over 100 years old, but making a practical high-performance version suitable for vehicles has not been possible until recently. A combination of new motor designs and the advent of powerful, fast-switching semiconductor chips, which can be used to build more sophisticated versions of the electronic control systems required to operate a reluctance motor, is giving those motors a new spin.

One of the leading contenders is Inverto, a research and development company based in Ghent, Belgium. Inverto's engineers, led by John De Clercq, the firm's research director, are collaborating with the University of Ghent and the University of Surrey, in Britain, and also with an unnamed carmaker. They already have a motor running in a car. At Newcastle University, also in Britain, researchers are working with several companies to produce reluctance motors for both cars and lorries. And studies are being carried out in America and Japan too. A team led by Nobukazu Hoshi of the Tokyo University of Science, for example, has experimented with a reluctance motor in a Mazda sports car.

Let's twist again

The main practical difference between a reluctance motor and a normal one is that the reluctance motor has no permanent magnets. A normal motor (one that runs on direct current, at least) has two parts. One, the rotor, moves. The other, the stator, does not. The stator usually forms the casing and houses a set of permanent magnets. The rotor, which turns inside that casing, is surrounded by copper windings that act as electromagnets. The motor works by the periodic reversal of the current running through these windings. That reverses the polarity of the electromagnets and causes the rotor to be pulled around by attraction and repulsion between the electromagnets and the permanent magnets.

Traditionally, this current reversal was achieved with a rotary switch known as a commutator, which transmitted electricity to the windings through brushes that made contact with conductive strips which passed under them as the rotor turned. Modern motors use electronic control systems rather than a commutator, but the principle is the same.

A switched reluctance motor is like a normal modern motor in this respect—it is also brushless. But unlike a normal motor it has no need of permanent magnets, rare-earth or otherwise, for it works on a different principle: least magnetic reluctance.

Reluctance in magnetism is analogous to resistance in electricity. Just as a current travels along the path of least resistance, so the flux of a magnetic field (the "lines of force", for those who remember childhood experiments with bar-magnets, sheets of paper and iron filings) takes the path of least reluctance. And iron, a material that is nice and cheap, has very low reluctance.

Inverto's reluctance motor has a rotor made of iron sheets, while the inside of the stator is covered with copper windings. Current is fed to these windings on the say-so of the control system, generating flux. That flux then follows the path of least reluctance—ie, through the sheet-iron rotor. The rotor attempts to align itself to the flux in a way that reduces reluctance to a minimum, and that causes it to turn.

The control system, however, constantly anticipates the rotor's movement and switches the current between windings so as to stop the rotor settling into its preferred alignment. As a result, it keeps on turning.

Reluctance motors still have disadvantages, even now that the control problem has been solved. For example, to deliver a given amount of twisting force—or tor- ▸▸

que—a reluctance motor has to be larger than an equivalent permanent-magnet motor. But the materials needed to build them are significantly cheaper. Moreover, according to Dr De Clercq, the motors' torque characteristics make them particularly suitable for cars.

At high speeds, for example, they do not lose torque as quickly as a permanent-magnet motor would. That helps during overtaking. They are also safer when they fail. If a permanent-magnet motor loses power suddenly it slows down rapidly, creating an unexpected braking effect. That might also damage the motor. A reluctance motor, by contrast, freewheels if the power is cut off. Despite that, it can still act as a generator when slowing down, as permanent-magnet motors do in electric cars. (Generators are, basically, electric motors in reverse. They convert motion into electricity instead of electricity into motion. A slowing motor can thus be used to top up a car's batteries with energy that would otherwise be lost in braking.)

The researchers at Newcastle are working with Tata Steel, part of an Indian conglomerate, on using special steels to exploit the magnetic flux more effectively and hence extract more power. They are also collaborating with a local firm, Sevcon, which makes power electronics, and Cummins Generator Technologies, part of an American group which builds engines, on reluctance motors for hybrid trucks. James Widmer, who leads the Centre for Advanced Electrical Drives, one of the reluctance-engine-research groups at Newcastle, says that by running their new motors at high speeds it should be possible to outperform the best fixed-magnet motors, and to do so at lower cost.

The chances are good, therefore, that powerful switched reluctance motors will emerge. That does not automatically mean they will be commercialised, but if the price of rare earths remains high, there is a strong chance that will happen. And if it does, the need for dysprosium and neodymium will diminish quite a lot. China may thus find that, like the farmer in the fable who killed the goose that laid golden eggs, its desire for short-term advantage brings long-term regret. ■

Supercomputing

Deeper thought

The world has a new fastest computer, thanks to video games

SPEED fanatics that they are, computer nerds like to check the website of Top500, a collaboration between German and American computer scientists that keeps tabs on which of the world's supercomputers is the fastest. On November 12th the website released its latest list, and unveiled a new champion.

The computer in question is called "Titan", and it lives at Oak Ridge National Laboratory, in Tennessee. It took first place from another American machine, IBM's "Sequoia", which is housed at Lawrence Livermore National Laboratory, in California. These two machines have helped reassert America's dominance of a list that had, in the past few years, been headed by computers from China and Japan.

Titan is different from the previous champion in several ways. For one thing, it is an open system, meaning that scientific researchers with sufficiently thorny problems will be able to bid for time on it, in much the same way that astronomers can bid for time on telescopes. Sequoia, by contrast, spends most of its time running hush-hush simulations of exploding nuclear weapons, and is therefore rarely available for public use.

Titan has an unusual design, too. All supercomputers are composed of thousands of processor chips harnessed together. Often, these are derivatives of the central processing units, or CPUs, that sit at the heart of modern, desktop machines. But Titan derives the majority of its oomph—more than 90%—from technology originally developed for the video-game industry. Half of its 37,376 processors are ordinary CPUs. But the other half are graphics processing units, or GPUs. These are specialised devices designed to cope with modern video games, which are some of the most demanding applications any home machine is ever likely to run. China's "TianHe-1" machine, a previous Top500 champion, was built in the same way, as are 60 other machines in the Top500 list.

Parallel worlds

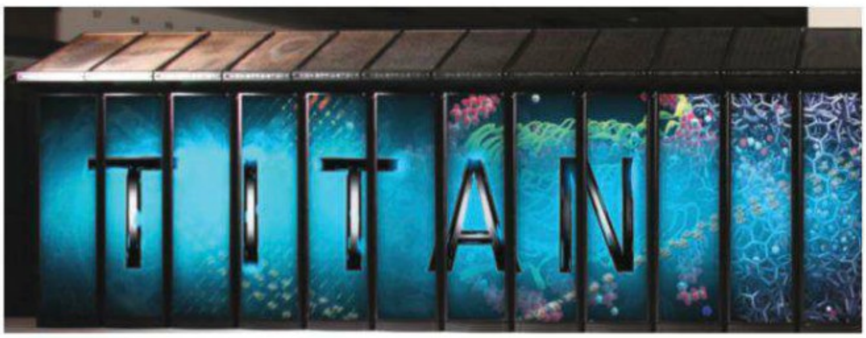
Broadly speaking, a CPU—which will be expected to run everything from spreadsheets to voice-recognition software to encoded video—has to be a generalist, competent at every sort of mathematical task but excelling at nothing. A GPU, by contrast, is designed to excel at one thing only: manipulating huge numbers of the triangles out of which all modern computer graphics are made.

Several years ago researchers at Nvidia and AMD (the two companies that produce most of the world's high-performance GPUs) realised that many scientific problems which demand huge amounts of computing power—everything from climate simulations and modelling combustion in an engine to seismic analysis for the oil-and-gas industry—could be translated into a form that was digestible by their GPUs. Soon after, supercomputer builders such as Cray (which put Titan together using Nvidia's GPUs) began to take notice.

Borrowing from the games industry in this way brings several benefits. One big one is efficiency. Titan is an upgrade of Oak Ridge's existing "Jaguar" machine. Upgrading Jaguar with ordinary CPUs would have meant building a computer that sucked around 30MW of electricity when running flat out—enough juice to power a small town. Because GPUs are so good at their specialised tasks, Titan can achieve its blistering performance while sipping a (relatively) modest 8.2MW.

It makes sense financially, too, says Sumit Gupta, head of supercomputing at Nvidia. The chips that the firm sells to supercomputer-makers are almost identical to those it sells to gamers. As Dr Gupta observes, "The history of high-performance computing is littered with the bodies of firms that tried to build products just for the supercomputing market. By itself, it's just too small a niche."

It is not all upsides, though. Machines like Titan achieve their speed by breaking a problem into thousands of tiny pieces and farming each out to a single processor. A ▸▸



The ultimate games machine

helpful analogy, perhaps, is painting a house: one strategy might be to hire a single painter, but it is probably quicker to employ several people and give each a room to do.

Not all problems are susceptible to being chopped up in such a way, though (hiring a dozen barbers, to take another analogy, is unlikely to speed up a haircut significantly). The requirement to translate a problem into the sort of mathematics that a GPU can digest adds another barrier. Dr Gupta gives the example of the models used to simulate how a car will react in a crash as one problem that has so far resisted what the industry calls the "massively parallel" approach. Clever programmers can sometimes find a way around such issues: ray-tracing, a high-quality, mathematically intense approach to computer graphics that aims to simulate individual light rays, was, ironically, long thought to be the kind of problem that a modern GPU would struggle with. Yet at a graphics conference in 2008, a group of researchers from Nvidia announced that they had, nevertheless, found a way to do it.

Oak Ridge and Nvidia plan to work with scientists wanting time on Titan to see if their algorithms can be tweaked in similar ways, to make them digestible by the new machine. Dr Gupta is bullish. Even the recalcitrant car-crash simulations, he thinks, will yield to the new approach soon. But that is not to say that every problem can be made to work. And those scientists who find that they cannot tweak their code may find themselves struggling to take advantage of the ever-rising performance of the world's fastest computers. ■

Post-traumatic stress disorder

Battle ready?

It may be possible to "vaccinate" soldiers against the trauma of war

WITH its deafening explosions, searing fires, dismembered corpses and stench of death, war pushes everyone it touches to the brink. Most recover naturally. Some, though, suffer psychological injuries that do not heal. The names of these injuries have changed. Once they were known as shell-shock; then as battle fatigue; then as combat stress reaction. Now, the preferred term is post-traumatic stress disorder. But whatever they are called, they are worryingly common. About 17% of American troops returning from Iraq and 11% of those coming back from Afghanistan suffer from them.

The most common treatment is known as exposure-based therapy. This asks those afflicted to imagine the sights and sounds that traumatised them, and helps them confront those memories. It often works. But not always. And it would undoubtedly be better if troops did not develop the condition in the first place.

With this in mind, a team of engineers, computer scientists and psychologists led by Skip Rizzo at the University of Southern California propose a form of psychological vaccination. By presenting soldiers with the horrors of war before they set off to fight, Dr Rizzo hopes to inure squaddies to anything they might witness on the field of battle.

The idea of doing this developed from Dr Rizzo's work using virtual reality to help with exposure-based therapy. Such VR enables the sights, sounds, vibrations and even smells of the battlefield to be recreated in the safety of a clinic, and trials suggest it can help those who do not respond to standard exposure-based therapy. The success of such simulation led Dr Rizzo to wonder if a similar regime, experienced before actual battle, might prepare troops mentally in the way that traditional training prepares them physically. His preliminary results suggest it might.

The virtual training course Dr Rizzo and his team have developed leads soldiers through a tour of duty that includes seeing and handling human remains, experiencing the death of virtual comrades to whom they have become emotionally close, and watching helplessly as a child dies. Unlike a real battlefield, though, a virtual one can be frozen, and events occurring there discussed at leisure. When that happens, a virtual mentor emerges from the midst of the chaos to guide the user through stress-reduction tactics he can deploy. These may be as simple as breathing deeply, or as sophisticated as objectively recognising normal reactions to stress, and thus realising that your own reactions are normal too.

To monitor what is going on Dr Rizzo's colleague Galen Buckwalter tracks physiological markers of stress, such as the reactions of participants' pupils to what their eyes are seeing, their electrocardiograms and their galvanic skin responses. Dr Buckwalter hopes that as his charges become more psychologically prepared for battle, these markers will change in recognisable ways. This will allow officers to identify who is, and is not, ready for combat.

That would be an obvious boon. But it could also create problems, for it is a long-standing belief of most armed forces that, with proper training, anyone can become a warrior. Dr Buckwalter's work would undermine this philosophy if it showed that no amount of training was ever going to change some people's markers.

If that were the case, should such soldiers then be excused active duty? As things stand, those with physical limitations who apply to serve in America are still recruited, but are given only work that they are physically capable of doing. Should applicants with psychological limitations be treated similarly?

Perhaps they should. For if it does prove possible to sort those who are likely to become inured to war's horrors from those who will not, one result would be a more effective fighting force. A second would be the consequential elimination of one of those horrors—the psychological wounds that are often regarded by soldiers who suffer them as worse than physical ones. ■

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Randomness, probability and uncertainty

Stress best

How surprises make you stronger

> **Antifragile: Things that Gain from Disorder.** By Nassim Nicholas Taleb. *Random House; 519 pages; $30. Allen Lane; £25*

WHAT is the opposite of fragility? Though not quite right, "resilience" and "robustness" are two words that come to mind. If fragility means something that breaks under stress, its exact opposite should mean something that grows stronger under pressure. There is no word that quite captures this, says Nassim Nicholas Taleb, an American essayist and scholar, so he has invented one: "antifragile".

The neologism is necessary because antifragility, he argues, is the secret to success in a world full of uncertainty. Mr Taleb's earlier books were devoted to showing that no one can measure the likelihood of rare events—or "black swans", in his now famous phrase. From the financial crisis to the tsunami that struck the Fukushima nuclear reactor in 2011, the worst-case scenario will never be quite bad enough. So instead of trying to predict the future and failing, the best thing to do is try to benefit from shocks when they occur.

That, after all, is what nature does. Evolution is a system for turning random mutations to lasting advantage. The body responds well to certain pressures; the bones in the racquet-holding arm of professional tennis players are stronger than those in the other arm, for example.

There are all sorts of ways in which bad events contain useful information. Pain teaches children what to avoid. The failures of past entrepreneurs steer the next lot of start-ups away from the same mistakes. Plane crashes yield data that make the next flight safer. (Bank failures have the opposite effect; because of the interconnectedness of the financial system, one blow-up makes another more likely, not less.)

Indeed, Mr Taleb thinks the big mistake is trying too hard to avoid shocks. Long periods of stability allow risks to accumulate until there is a major disaster; volatility means that things do not get too far out of kilter. In the economy cutting interest rates at the first sign of weakness stores up more trouble for later. In markets getting rid of speculators means prices are more stable in general but any fluctuations cause greater panic. In political systems the stability brought by regimes such as Hosni Mubarak's in Egypt was artificial; without any effective way for people to express dissent, change leads to collapse.

The principle applies to career choices too. An apparently secure job within a large company disguises a dependency on a single employer and the risk that unemployment will cause a very sudden and steep loss of income. Professions that have more variable earnings, like taxi-driving or prostitution, are less vulnerable to really big shocks. They also use volatility as information: if a cabbie is in a part of town where there are no fares, he heads to a different area.

This is getting to the heart of antifragility: being in a position where the unexpected allows improvement, where the potential gains from a surprising event outweigh the potential losses. The obvious example from finance is the option, which gives the buyer the right, but not the obligation, to undertake a transaction at an agreed price. The first option on record was exercised by Thales of Miletus, an ancient Greek philosopher who bought the right to use every olive press in the area and was then able to specify his terms when a good olive harvest meant high demand for the presses. At worst, his losses were limited; at best, his gains were enormous.

The equivalent in investment terms is to hold mostly ultra-safe assets and have a sliver of wealth in something that offers a huge pay-off if there is a positive surprise. In business, inefficiency becomes a potential virtue; holding lots of inventory is a great strategy if there is a shortfall elsewhere in the market. As for countries, Switzerland takes the prize for being the "most antifragile place on the planet". When bad things happen, the money flows in.

"Antifragile" is an interesting idea, but as a book it is not without flaws. Mr Taleb takes on everything from the mistakes of modern architecture to the dangers of meddlesome doctors and how overrated formal education is. He overstretches the argument and is not as iconoclastic as he likes to think. There is a lot of familiar-sounding praise for Steve Jobs and the warnings about the dangers of stability will be well known to followers of Hyman Minsky. The valid reasons why people ▸▸

become employees (pensions, say) or companies become bigger, such as economies of scale, are skated over. But this is an ambitious and thought-provoking read.

It is also a highly entertaining one, thanks to Mr Taleb's in-your-face nature. "Antifragile" is as much about the author as it is about the world. He is a weightlifter and calls himself "an intellectual who has the appearance of a bodyguard". He avoids fruit that does not have an ancient Greek or Hebrew name and drinks no liquid that has not been in existence for at least 1,000 years. He has little time for copy editors, even less for economists, bankers and those who cluster at Davos. He once spent two years in bed reading every book about probability he could lay his hands on. Whether you find Mr Taleb amusing or irritating, you want to read on. ■

Aid and trade

Dam lies

The Politics and Economics of Britain's Foreign Aid: The Pergau Dam Affair. By Tim Lankester. *Routledge; 194 pages; $145 and £85*

IT IS easy to understand why tying foreign aid to exports appeals to rich-world politicians. It seems to kill so many birds with one stone: international do-goodery; jobs and profits at home; perhaps, as a consequence, corporate donations for your party. It is also easy to see why the marriage will always be fraught. The exporters' interests—to maximise profits—are in direct competition with the interests of the aid recipients. It is more than likely that this tension will be reflected not just in difficult negotiations with the exporters and their customers but in fierce turf battles between the various government departments involved.

Rarely, if ever, however, has the tension degenerated into such acrimony and embarrassment as in Britain over the Pergau dam in Malaysia, a big hydroelectric project first proposed as a target for British aid in 1988, and commissioned in 1996. Sir Tim Lankester, a former British civil servant who played a central role in the affair, has now produced a gripping account of what Douglas Hurd, Britain's foreign secretary from 1989-95, called, with typically patrician understatement "a fairish nightmare".

The project entailed at least three separate scandals. First, in contravention both of international agreements and Britain's own stated policy, aid for the project was linked to unrelated orders Malaysia placed for British defence equipment. Second, the economics of the project itself were, in Sir Tim's phrase, "unambiguously bad and, what is more, on a very substantial scale". Malaysia could have produced electricity far more cheaply from other sources. And as for the benefits to Britain, each man-year of employment the project generated came at a cost to the taxpayer of £16,135 (in 1991, about $29,000).

Third, unproven allegations of corruption swirled around the project. Less contentiously, when the Malaysian utility which received the heavily subsidised loan was privatised, its shares were priced far too low. So the British aid benefited the well-placed Malaysian institutions and individuals who bought them.

The consequences were severe. Pergau brought acute embarrassment for the government of John Major, who inherited the problem from Margaret Thatcher. In 1994 a court ruled that Lord Hurd, as he later became, had acted unlawfully in approving the aid. It all added to the sense of *fin-de-régime* disarray in the Conservative government which brought electoral rout in 1997. The British press's coverage of the furore led to a Malaysian public-sector boycott of British contractors. Not much went right, really.

Sir Tim had a ringside seat in all this, and provides a lucid analysis of how the disaster unfolded. It helps that his own record in the mess is a creditable one. He counselled against the project, and, unusually, insisted on a formal ministerial ruling before signing off on it.

His book amounts to a defence of the British civil service in general and the aid department in particular. The blame, rightly, lands on the politicians, and in particular on the formidable Mrs Thatcher (as she then was), whose commitment over Pergau in 1988 to her Malaysian counterpart, Mahathir Mohamad (pictured below, left), no yes-minister bureaucrat or cowed minister afterwards dared countermand. At the time, Sir Tim was both praised and excoriated as a whistle-blower, and his dissent on the project may have cost him his career. But had he or another civil servant blown the whistle earlier on the disgraceful link to the arms deal—which amounted to intergovernmental bribery on a massive scale—the whole sorry saga might very well have been averted. ■

In step together

The euro

Eurogeddon

Greekonomics. By Vicky Pryce. *Biteback Publishing; 282 pages; £12.99*

Europe's Unfinished Currency. By Thomas Mayer. *Anthem Press; 262 pages; $26.95 and £19.99*

USEFUL books on the euro crisis are hard to write; the subject is confusing and it never seems to end. Yet a number of bold writers are having a go, especially those who say European governments are getting it wrong. That group includes Vicky Pryce and Thomas Mayer, two leading commentators who agree that the euro needs fixing and that the politicians don't get it—but disagree on how and why.

As a Greek economist working in London, Ms Pryce naturally begins with Greece. She calls it a classic clientelist state. Not least because it made up its numbers, it should never have got into the euro. Greece also fell into the Mediterranean trap of enjoying low interest rates but failing to reform the economy. It should have surprised nobody when, in May 2010, it became the first country needing a bail-out.

Ms Pryce canters briefly around other troubled countries, including Britain, before returning to the Greek mess. She offers three persuasive, if irreconcilable, conclusions unless Germany pays much more: that a Greek exit from the euro is too dangerous; that Greece cannot repay its debts; and that a diet of perpetual austerity risks killing the patient. Greece needs growth and debt relief, not more budget cuts and youth unemployment at over 50%.

As a German economist, Mr Mayer agrees that the present course is unsustainable, but not on how to change it. For him (as for Hans-Werner Sinn, author of the controversial "Die Target-Falle"—the target trap—recently published in German) repeated bail-outs and the partial mutualisation of debt via the European Central Bank have gone too far. The fear is that bailing out debtors creates moral hazard and eases the pressure for reform. Since fuller political union with a large central budget is not

Roger Scruton on his knees

Book of lamentations

Our Church: A Personal History of the Church of England. By Roger Scruton. *Atlantic; 199 pages; £20. To be published in America in February; $32.95*

TO ENGLISHMEN of Roger Scruton's generation (he is 68), religion was "as unmentionable as sex or love or hygiene". The clumsy soul who stops by a country church in Philip Larkin's 1955 poem, "Church Going", speaks of an "awkward reverence". This seems to be what Anglicanism means for many: God, as depicted in church services, is an Englishman, "uncomfortable in the presence of enthusiasm, reluctant to make a fuss, but trapped into making public speeches", says Mr Scruton.

It is strange then that a church which defined a nation—a religion that folk were once burned for—is now scarcely remarked upon. This summer's Olympic opening ceremony paid homage to human rights and the National Health Service, but put on little pageantry for religion. Mr Scruton, one of Britain's foremost conservative philosophers, bemoans the decline of "our church". His book is not intended to be a complete history but a personal elegy.

Mr Scruton's work has a spurtive, poetic quality to it. Justifications of Anglican doctrine lie beside the author's thoughts on his village church. Literary quotations follow portraits of theologians, thinkers and architects. A short sketch of John Milton, would-be Royalist who abhorred authority, is placed next to a profile of Thomas Hobbes, a pauper's son who promoted tyranny.

The church that emerges is not one that unifies the nation, as English historians commonly suppose. It splits the country, and then steadily loses supporters because of its middle-of-the-road Christianity. The Elizabethan religious settlement, sometimes hailed as a canny compromise that keeps the peace, does not prevent England being riven apart by religious conflict in the 17th century. The civil war is not purely a class struggle, says Mr Scruton. The most heated parliamentary squabbles were about faith and were inspired by faith, he says. The Book of Revelation was as poisonous in Stuart England as "The Communist Manifesto" was in Romanov Russia.

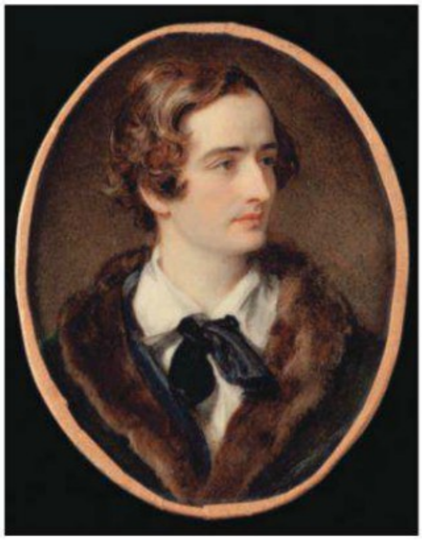
The Church of England, once professed to be *katholikos* (universal), soon became Anglicanism, one sect of many. Low-church revivalists like John Wesley disliked how comfortably clergymen lived in 18th-century England. High-church folk like John Henry Newman and Augustus Pugin, who helped design the Houses of Parliament, preferred sacraments and showy chapels. John Ruskin scorned Pugin for allowing himself "to be stitched into a new creed by the gold threads on priests' petticoats". Nevertheless, says Mr Scruton, Wesley and Newman were "the two greatest apostles of Christ that the Church of England has produced, and it could contain neither of them".

Zealotry turned into apathy. As George Orwell wrote in 1941, "The common people [of England] are without definite religious belief, and have been so for centuries." Larkin's churchgoer only enters the church "Once I am sure there's nothing going on". Mr Scruton, a man prone to bouts of lamentation, has produced a delightfully short chronicle of the church's decline. But in telling the history of tiffs, fudges and rifts, he only leaves the reader thinking: well, no wonder.

on the cards, Mr Mayer suggests restoring market forces by allowing euro-zone countries to go bust and even to leave the single currency. If American states can default, he asks, why not euro-zone countries?

It is a reasonable question, and it may explain why the euro treaties did not provide for a lender of last resort or bail-outs and stopped the ECB buying government-bond issues. Yet the American analogy does not quite work, and not only because the United States has a more flexible economy and a far bigger federal budget. The crucial difference is that nobody doubts the dollar's future existence. Yet Mr Mayer's brief history of currency unions shows how transient they can be. Throughout the crisis markets have questioned the euro's survival.

That makes it harder to take a tough line on countries like Greece. Many Germans share Mr Mayer's view that Greece ought to go; but the markets are unlikely to stop there, turning to Portugal, Spain, Italy and even France. A worry about such unravelling is what drives the German government to want Greece to stay. But a Greek economy in near-permanent depression will need support for years to come. Unless and until creditor countries grow faster, which may mean accepting higher inflation, the euro crisis will not go away. ■



Romantic poetry

The gospel according to John

John Keats: A New Life. By Nicholas Roe. *Yale University Press; 446 pages; $32.50 and £25*

AT FIRST glance, John Keats did not seem an imposing figure. He stood just over five feet tall, with a "small head and faded hands with swollen veins". During his lifetime, he would be dismissed by some as a self-taught "cockney poet" who gave up his medical career to write poetry that was, in another poet's opinion, a "sort of mental masturbation."

And yet, by the time he died at 25 in 1821 from tuberculosis, Keats had written some of the finest Romantic poetry. Both shocking and inspiring the Victorian generation following him, after his death he became venerated as a waiflike figure who delighted in "delicious diligent indolence". The posthumous image of him is of an ethereal, fragile poet.

Nicholas Roe's biography tries to debunk the mythology that quickly emerged. The Keats that arises from Mr Roe's book is very different from either the cockney bard or the pale romantic adolescent dreaming up wanton females and hallucinogenic poetic imagery of popular imagination.

This Keats is "sparkling, tipsy, unpredictable". He likes "women, wine and snuff" and is adept at fencing and boxing. On a trip to Scotland in 1818, he walks over 640 miles in 43 days, returning to London bronzed and dishevelled. Before giving up his medical training, he juggles his work at Guy's Hospital in London with his poetry, writing in the evenings after dressing wounds and helping carry away amputated limbs. He is an avid theatregoer and heavy drinker, often seeking out the com-

pany of his male friends to competitively discuss their verse with each another.

Mr Roe, an academic, likes the traditional linear form of biography. He starts with Keats's father's death, when his son was eight, from a riding accident just outside London. Mr Roe traces back most of Keats's inspiration to his parents' early deaths. Keats's mother died six years after his father, sensing in his "hopes for poetic glory" a "conversation with his dead parents to whom he could speak in no other way." He evokes the spaces Keats lived and wandered about in and with meticulous research compares different drafts of Keats's poems or his handwriting as a medical student and as a poet.

Certain aspects of this biography work less well. Mr Roe often relies on speculation and guesswork. His theme of Keats being haunted by his parents is emphasised at the expense of some of the more interesting parts of the poet's life, such as his relationship with Fanny Brawne. Many of the revelations touched upon by Mr Roe appear in Keats's own letters. However, Mr Roe's biography, if not as new as its subtitle suggests, does manage to capture something of the self-proclaimed "camelion [sic] Poet". With a mind, as Keats complained to Brawne, "put into a body too small for it", Keats was always larger than his slight frame suggested. This biography gives another picture of the man, and suggests there is space for a more expansive view of the poet. ■

Classical music

Spiralling notes

SALZBURG

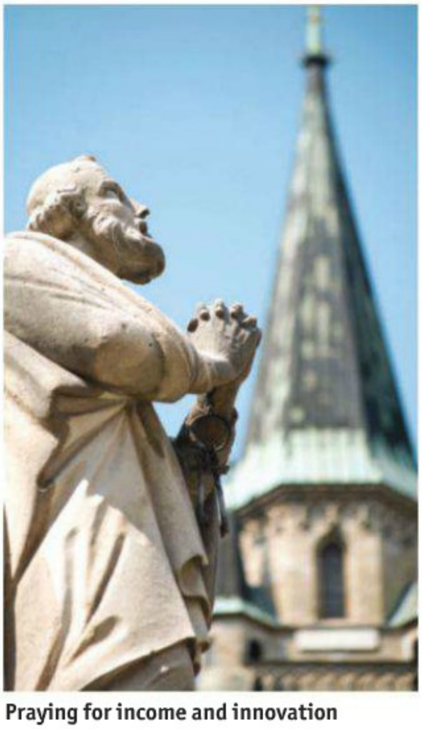
A new artistic director is shaking up the summer festival

THE Salzburg festival was born in 1920 and is regarded as the pole star of the operatic world. The annual summer gathering runs from the middle of July until early September, bringing over 250,000 visitors to this otherwise sleepy, mountain-ringed city, all of them so hungry for its cultural offerings that they will pay up to €400 ($508) for an ordinary ticket.

These figures suggest that the festival is in good shape, but the truth is more complex. Alexander Pereira believes Salzburg was heading for trouble when he took over as artistic director a year ago. With rising costs—the festival employs some 200 permanent staff and nearly 4,000 during the summer—and a ten-year freeze on government subsidies, its finances were becoming so squeezed that the festival could no longer invest in new opera productions. Increasingly, it was being forced to rely on revivals of hand-me-down productions; fine for a year or two, he says, but not for the long term.

Mr Pereira's strategy has in one sense been a simple one: to increase revenue from corporate sponsors. Many organisations long to do this, but few succeed, especially in a recession. Within months, though, Mr Pereira signed up €5m of new commitments, bringing Salzburg's corporate income to €13m, the same as it gets every year from government sources.

Vienna-born Mr Pereira ran the Zurich opera house for 20 years. Before that he worked in business and tourism, first with the Austrian tourist board and then for the Italian business-systems manufacturer, Olivetti, where he headed a German sales division and made useful contacts among the banks and pharmaceutical companies that were his chief clients.



Praying for income and innovation

More surprising than this smooth cross-fertilisation of business and culture, however, is Mr Pereira's artistic agenda, which has turned out to be unequivocally progressive, even aggressive. For many, increased reliance on sponsorship implies artistic conservatism; keeping the punters happy. But Mr Pereira is convinced that artistic innovation is as attractive to corporate sponsors as it is essential to ensuring that Salzburg retains its position at the tip of what he refers to as the "iceberg of the operatic and musical world". Companies that have a strong research and development ethos are keen to be part of what Mr Pereira calls the "cutting edge of international culture".

As a result, Salzburg is now planning to stage at least five new productions each summer (a figure some opera houses struggle to reach in a year), including a major new opera every year. His predecessors dreamed of this, but never quite succeeded. One of the highlights of the 2012 festival was a staging of Bernd Alois Zimmermann's modernist tragedy, "Die Soldaten", a work that is both expensive and demanding—of musicians, singers and stage technology, as well as the audience. The two performances which your correspondent attended were both sold out and enthusiastically received.

Next year's programme, which will be announced later this month, will include a new production of Harrison Birtwistle's "Gawain", which is based on the 14th-century Arthurian story about Sir Gawain and the green knight and which has never been seen outside London's Royal Opera House.

Other highlights will be new productions of Wagner's "Die Meistersinger" and Verdi's "Don Carlo" and "Falstaff"—to mark the composers' bicentenaries in 2013—as well as some of their less well-known early works. Salzburg's concert programmes will centre on a complete Mahler symphony cycle, performed in part by the various orchestras from *el sistema*, Venezuela's pioneering music education network. The *el sistema* children's orchestra, where the average age of the musicians is ten, will appear for the first time in Europe, launching the cycle with Mahler's first symphony conducted by Sir Simon Rattle.

Further down the line, there are plans for putting on a long-awaited opera by a revered, but unhurried, Hungarian composer, Gyorgy Kurtag, and a new work by Thomas Adès, a British composer whose "Tempest" is currently on at the Metropolitan Opera in New York.

Mr Pereira's no-holds-barred approach has its critics. But he has impressed both the federal and local governments, which are now considering meeting the cost of raising salaries for festival staff, an annual increase of about €600,000. A recent independent report by Salzburg University calculated that the festival's overall economic effect amounted to €276m, of which direct tax revenue came to €36m, almost three times the sum paid in subsidies. The report, no less than Mr Pereira's energetic approach, is one that other challenged cultural leaders could study with profit. ■

Regional Director for Latin America and the Caribbean

The Open Society Foundations (OSF) work to build vibrant and tolerant democracies whose governments are accountable to their citizens. To achieve this mission, the Foundations seek to shape public policies that assure greater fairness in political, legal, and economic systems, as well as safeguard fundamental rights. At the local level, the Open Society Foundations support and implement a range of initiatives to advance justice, education, public health, and independent media. At the same time, we build alliances across borders and continents on issues such as corruption and freedom of information. OSF is currently seeking a Regional Director for Latin America and the Caribbean. The Regional Director will be a member of the senior management of the larger Open Society Foundations. Leading a program team, the Regional Director is responsible for coordinating our overall institutional engagement in Latin America and the Caribbean. The Regional Director oversees a robust grant making program, in addition to advocacy with regional and international bodies, multi-lateral and bilateral organizations, and governments. Qualifications include: Advanced degree; extensive knowledge and experience in Latin America; experience working with NGOs, international organizations, and/or grant-making institutions; Fluency in English, Spanish and Portuguese; and excellent organizational and leadership skills.

To apply: qualified candidates should send a CV, a two or three page cover letter describing your interests and experience, and one writing sample before December 9th to: HumanResources@opensocietyfoundations.org include job code in subject line: **RD-LAP**. Applications will also be reviewed on a rolling basis, and early submissions are strongly encouraged. For more information on this position please visit: http://www.opensocietyfoundations.org/about/jobs/regional-director-latin-america-and-caribbean

Tenders

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The closing date for submission of proposals is 7 December 2012.

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Expression of Interest
Offshore Transmission: West of Duddon Sands

Ofgem E-Serve invites Expressions of Interest from suitably experienced organisations wishing to tender for the opportunity to operate and maintain the West of Duddon Sands wind farm offshore transmission assets.

The 389 MW West of Duddon Sands wind farm project is located in the Irish Sea.

Ofgem E-Serve is responsible for granting offshore transmission licences, through a competitive tender process, which enables the connection of offshore wind farms to the onshore grid.

As part of the Pre-Qualification stage, bidders will be invited to demonstrate to Ofgem that they have a sufficiently robust track record against a set of pre-defined requirements in order to be invited to participate in subsequent tender stages.

Expressions of Interest should be sent by email to tendercoordinator@ofgem.gov.uk by 12.00 noon on 10 December 2012, at the latest.

An event for organisations interested in the West of Duddon Sands transmission assets, and other opportunities to invest in the offshore regime, will be held in London on 26 November 2012.

If you have any queries please email **tendercoordinator@ofgem.gov.uk** or visit our website at **www.ofgem.gov.uk/offshore**

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DH Department of Health

Review Body on Doctors' and Dentists' Remuneration (DDRB)

Economist Member

DDRB is independent of Government. Its primary role is to make annual recommendations to the Government on the remuneration of doctors and dentists employed in the NHS. This key appointment provides an interesting insight into the NHS and makes an important contribution to recruiting, retaining and motivating an effective NHS workforce.

The Secretary of State for Health wishes to appoint an Economist Member of DDRB. We are looking for candidates with the ability to apply their expertise to labour market issues, and the necessary status and record of achievement. Candidates should have intellectual flexibility; the ability to analyse and interpret information; independence of thought and effective influencing and communication skills; an appreciation of public sector reward; high standards of corporate and personal conduct; and the ability to work in a team.

Time commitment and remuneration
Time commitment for this post is likely to be around 15 days a year for which an attendance allowance of £300 per day is payable. Reimbursement for travel and subsistence is also payable. Meetings are held in London and there are visits to NHS organisations across the UK.

How to apply
For more information, please visit our website **www.dh.gov.uk/appointments.** If you require an alternative format such as Braille, large print or audio please call Samantha Alcock on 0113 254 5845 quoting the reference **A12-25.**

The closing date for applications is 12 noon on 26 November 2012.

We value and promote diversity and are committed to equality of opportunity for all and appointments made on merit.

Fellowships

Alfa Fellowship Program

Alfa-Bank and Cultural Vistas are pleased to announce a call for applications for the Alfa Fellowship Program's 2013-2014 program year. Now hosting its tenth group of Fellows, the Alfa Fellowship Program is a professional-level initiative designed to foster a new generation of American and British leaders with meaningful professional experience in Russia.

The Alfa Fellowship begins with language training in the U.S. or U.K., followed by a language course in Moscow. Throughout the summer and into the fall, Alfa Fellows attend a seminar program with key Russian government, public, and private sector officials to discuss current issues facing Russia. Fellows then work at leading organizations in Russia, including private companies, media outlets, think tanks, and NGOs.

Eligible candidates must have a graduate degree and professional experience in business, economics, journalism, law, public policy, or a related field. Russian language proficiency is preferred. The Fellowship includes a monthly stipend, program-related travel costs, housing, and insurance.

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Promoting Understanding of Russia

Applications must be received no later than **December 1.**
Program information and the online application can be found at: **www.culturalvistas.org/alfa**

For more information, please contact:
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440 Park Avenue South, 2nd Fl | New York, NY 10016
T: 212.497.3510 | alfa@culturalvistas.org | www.culturalvistas.org/alfa

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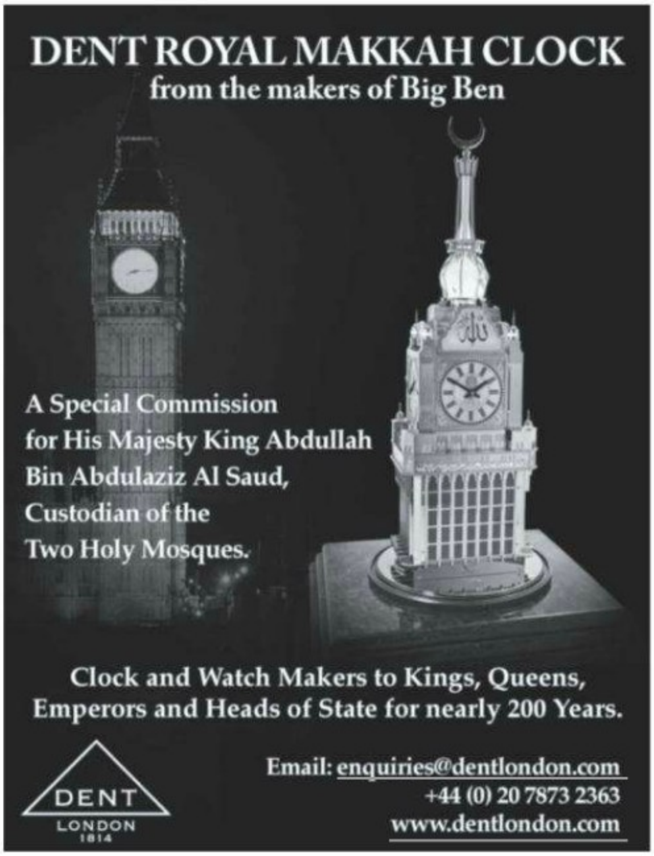

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Announcements

Zalkar Bank

AUCTION ANNOUNCEMENT

Offer: 409,000 Shares (100%)
Date of Auction: December 11, 2012
Place: Bishkek, Kyrgyz Republic

OJSC Zalkar Bank (Zalkar) is a leading retail bank in the Kyrgyz Republic, with an extensive network of ATMs and POS terminals.

The sole shareholder, the State Agency for Bank Reorganization and Debt Restructuring (DEBRA), is offering for sale 100% of the 409,000 shares of Zalkar. Zalkar's Board of Directors and DEBRA have retained International Finance Corporation (IFC) to advise on the proposed sale.

There will be no reserve price and no participation fee. Bidders must be physically present at the auction.

Interested investors should submit all inquiries and register their interest at the below address to receive due diligence materials and auction rules.

zalkar@ifc.org
Attention: Joseph Mik, Aknur Jumatova
International Finance Corporation
Tel: +7 (727) 2980-586 (ext.301, 249)
Mob: +7(701) 2206 756, +7 (707) 332-0026

IFC International Finance Corporation
International Finance Corporation World Bank Group
Transaction Advisor

State Agency for Bank Reorganisation and Debt Restructuring
Sole Shareholder

Economic data

% change on year ago

	Gross domestic product			Industrial production	Consumer prices		Unemployment	Current-account balance		Budget balance	Interest rates, %	Currency units, per $	
	latest	qtr*	2012†	latest	latest	2012†	rate, %	latest 12 months, $bn	% of GDP 2012†	% of GDP 2012†	10-year gov't bonds, latest	Nov 14th	year ago
United States	+2.3 Q3	+2.0	+2.1	+2.8 Sep	+2.0 Sep	+2.1	7.9 Oct	-477.8 Q2	-3.1	-7.0	1.59	-	-
China	+7.4 Q3	+9.1	+7.8	+9.6 Oct	+1.7 Oct	+2.9	4.1 Q3§	+208.3 Q3	+2.6	-2.3	3.25§§	6.23	6.35
Japan	+0.1 Q3	-3.5	+2.1	-8.1 Sep	-0.3 Sep	nil	4.2 Sep	+71.6 Sep	+1.3	-9.5	0.75	80.2	77.0
Britain	nil Q3	+4.1	-0.2	-2.6 Sep	+2.7 Oct	+2.7	7.8 Aug††	-88.0 Q2	-3.2	-8.4	1.69	0.63	0.63
Canada	+2.9 Q2	+1.9	+2.1	-0.5 Aug	+1.2 Sep	+1.8	7.4 Oct	-56.4 Q2	-3.1	-3.5	1.70	1.00	1.02
Euro Area	-0.4 Q2	-0.7	-0.5	-2.3 Sep	+2.5 Oct	+2.5	11.6 Sep	+89.1 Aug	+0.7	-3.3	1.33	0.79	0.73
Austria	+0.1 Q2	-7.3	+0.7	+3.5 Aug	+2.7 Sep	+2.2	4.4 Sep	+4.4 Q2	+2.0	-2.5	1.80	0.79	0.73
Belgium	-0.3 Q3	nil	-0.1	-2.5 Aug	+2.8 Oct	+2.7	7.4 Sep	-8.6 Jun	-0.2	-3.4	2.29	0.79	0.73
France	+0.3 Q2	-0.1	+0.1	-2.5 Sep	+1.9 Oct	+2.2	10.8 Sep	-51.3 Sep	-2.1	-4.5	2.11	0.79	0.73
Germany	+1.0 Q2	+1.1	+0.8	-1.1 Sep	+2.0 Oct	+2.0	6.9 Oct	+215.9 Sep	+5.7	-0.2	1.33	0.79	0.73
Greece	-7.2 Q3	na	-6.4	-7.2 Sep	+1.6 Oct	+1.0	25.4 Aug	-15.5 Aug	-6.6	-7.6	17.66	0.79	0.73
Italy	-2.5 Q2	-3.0	-2.4	-4.8 Sep	+2.6 Oct	+3.2	10.8 Sep	-32.3 Aug	-1.8	-2.8	4.96	0.79	0.73
Netherlands	-0.4 Q2	+0.9	-0.5	-0.2 Sep	+2.9 Oct	+2.5	6.6 Sep	+78.8 Q2	+8.0	-4.5	1.60	0.79	0.73
Spain	-1.6 Q3	-1.2	-1.6	-11.7 Sep	+3.5 Oct	+2.4	25.8 Sep	-36.0 Aug	-2.4	-8.3	5.91	0.79	0.73
Czech Republic	-1.7 Q2	-1.0	-1.0	-7.1 Sep	+3.4 Oct	+3.3	8.5 Oct§	-3.4 Q2	-1.9	-3.2	1.84	20.0	18.8
Denmark	-0.6 Q2	-1.6	+0.1	-5.5 Sep	+2.3 Oct	+2.4	6.3 Sep	+18.0 Sep	+5.5	-3.9	1.10	5.86	5.46
Hungary	-1.3 Q2	-0.9	-1.3	+0.4 Sep	+6.0 Oct	+5.8	10.4 Sep§††	+1.2 Q2	+1.1	-2.9	6.83	224	232
Norway	+5.0 Q2	+4.7	+4.0	-8.8 Sep	+1.1 Oct	+0.5	3.1 Aug‡‡	+77.7 Q2	+14.2	+13.5	1.97	5.76	5.70
Poland	+2.3 Q2	na	+2.4	-5.2 Sep	+3.4 Oct	+3.6	12.5 Oct§	-18.7 Sep	-3.8	-3.7	4.20	3.28	3.22
Russia	+2.9 Q3	na	+3.7	+1.9 Sep	+6.6 Oct	+5.1	5.2 Sep§	+102.9 Q3	+4.5	-0.6	7.70	31.8	30.5
Sweden	+1.3 Q2	+3.0	+0.9	-5.0 Sep	+0.4 Oct	+1.1	7.4 Sep§	+34.5 Q2	+6.5	-0.1	1.40	6.79	6.69
Switzerland	+0.5 Q2	-0.2	+1.0	-0.6 Q4	-0.2 Oct	-0.6	3.0 Oct	+78.0 Q2	+12.4	nil	0.51	0.95	0.91
Turkey	+2.9 Q2	na	+3.2	+6.2 Sep	+7.8 Oct	+9.2	8.4 Jul§	-59.0 Aug	-7.7	-2.6	7.59	1.81	1.78
Australia	+3.7 Q2	+2.6	+3.4	+0.5 Q2	+2.0 Q3	+1.8	5.4 Oct	-42.1 Q2	-3.7	-0.8	2.99	1.04	1.02
Hong Kong	+1.2 Q2	-0.2	+1.6	-3.0 Q2	+3.8 Sep	+4.1	3.3 Sep‡‡	+8.5 Q2	+5.4	+1.1	0.58	7.75	7.78
India	+5.5 Q2	+0.1	+5.8	-0.4 Sep	+9.8 Oct	+9.4	9.8 2011	-77.1 Q2	-4.0	-6.0	8.21†††	55.0	50.3
Indonesia	+6.2 Q3	na	+6.0	+7.6 Sep	+4.6 Oct	+4.4	6.1 Q3§	-18.5 Q3	-2.4	-2.4	na	9,628	8,965
Malaysia	+5.4 Q2	na	+4.9	+4.8 Sep	+1.3 Sep	+1.7	2.7 Aug§	+25.2 Q2	+6.7	-4.6	3.46	3.06	3.14
Pakistan	+4.2 2012**	na	+4.2	+4.0 Sep	+7.7 Oct	+10.0	6.0 2011	-2.9 Q3	-1.7	-6.6	11.25†††	95.9	86.7
Singapore	+1.3 Q3	-1.5	+2.4	-2.6 Sep	+4.7 Sep	+4.5	1.9 Q3	+50.6 Q2	+16.4	+0.9	1.32	1.22	1.29
South Korea	+1.6 Q3	+0.6	+2.6	+0.7 Sep	+2.1 Oct	+2.3	2.8 Oct§	+40.0 Sep	+2.1	+2.1	2.97	1,085	1,123
Taiwan	+1.0 Q3	+3.5	+1.3	+8.4 Feb	+2.4 Oct	+2.1	4.3 Sep	+43.5 Q2	+9.5	-2.8	1.12	29.0	30.2
Thailand	+4.2 Q2	+13.9	+6.0	-13.7 Sep	+3.3 Oct	+3.1	0.6 Jul§	+0.4 Q2	-0.6	-3.8	3.53	30.7	30.8
Argentina	nil Q2	-3.4	+2.1	-4.4 Sep	— ***	—	7.2 Q2§	+0.6 Q2	+0.4	-3.1	na	4.78	4.27
Brazil	+0.5 Q2	+1.6	+1.5	-3.8 Sep	+5.4 Oct	+5.3	5.4 Sep§	-49.9 Sep	-2.8	-2.5	9.57‡	2.07	1.76
Chile	+5.5 Q2	+7.1	+5.2	-0.7 Sep	+2.9 Oct	+3.1	6.5 Sep§‡‡	-6.8 Q2	-3.7	+1.4	na	485	502
Colombia	+4.9 Q2	+6.7	+4.4	-1.5 Aug	+3.1 Oct	+3.2	9.9 Sep§	-11.0 Q2	-3.6	-0.5	6.12	1,818	1,911
Mexico	+4.1 Q2	+3.5	+3.9	+2.4 Sep	+4.6 Oct	+4.1	4.7 Sep	-5.6 Q2	-0.7	-2.4	7.75	13.2	13.5
Venezuela	+5.4 Q2	+2.2	+5.0	+7.0 Jul	+17.9 Oct	+20.9	7.3 Sep§	+22.1 Q2	+5.1	-14.7	10.05	4.29	4.29
Egypt	+3.3 Q2	na	+2.2	-4.4 Sep	+6.7 Oct	+7.4	12.6 Q2§	-7.9 Q2	-3.2	-10.9	na	6.10	5.98
Israel	+3.4 Q2	+3.4	+3.0	+10.0 Aug	+2.1 Sep	+1.9	7.0 Q2	-0.2 Q2	-0.7	-4.0	3.99	3.96	3.72
Saudi Arabia	+7.1 2011	na	+5.6	na	+3.0 Sep	+4.6	5.4 2009	+169.1 Q1	+23.1	+12.0	3.68	3.75	3.75
South Africa	+3.0 Q2	+3.2	+2.5	-0.8 Sep	+5.5 Sep	+5.3	25.5 Q3§	-19.4 Q2	-6.3	-5.6	6.70	8.90	7.98

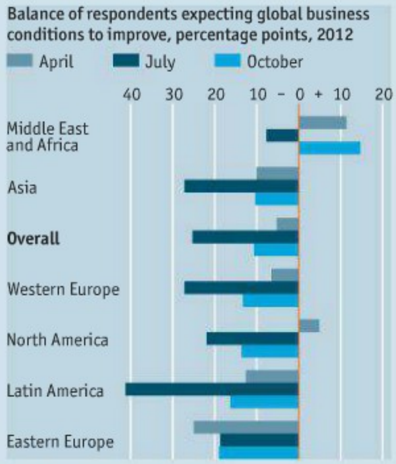
Source: Haver Analytics. *% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. §Not seasonally adjusted. ‡New Series. **Year ending June. ††Latest 3 months. ‡‡3-month moving average. §§5-year yield ***Official number not reliable; The State Street PriceStats Inflation Index, September 26.88%; year ago 24.38% †††Dollar-denominated bonds.

Markets

	Index Nov 14th	% change on one week	Dec 31st 2011 in local currency	Dec 31st 2011 in $ terms
United States (DJIA)	12,571.0	-2.8	+2.9	+2.9
China (SSEA)	2,152.4	-2.4	-6.6	-5.6
Japan (Nikkei 225)	8,664.7	-3.4	+2.5	-1.7
Britain (FTSE 100)	5,722.0	-1.2	+2.7	+4.7
Canada (S&P TSX)	11,929.8	-2.5	-0.2	+1.3
Euro area (FTSE Euro 100)	806.7	-0.5	+7.8	+5.7
Euro area (DJ STOXX 50)	2,472.8	-0.3	+6.7	+4.7
Austria (ATX)	2,175.9	-1.3	+15.0	+12.8
Belgium (Bel 20)	2,339.2	-1.1	+12.3	+10.1
France (CAC 40)	3,400.0	-0.3	+7.6	+5.5
Germany (DAX)*	7,101.9	-1.8	+20.4	+18.1
Greece (Athex Comp)	794.7	-3.8	+16.8	+14.5
Italy (FTSE/MIB)	15,252.9	-0.3	+1.1	-0.9
Netherlands (AEX)	330.7	-0.7	+5.8	+3.8
Spain (Madrid SE)	772.6	+0.3	-9.9	-11.7
Czech Republic (PX)	974.3	-1.5	+6.9	+5.0
Denmark (OMXCB)	442.0	+1.4	+23.9	+21.1
Hungary (BUX)	19,078.7	+1.0	+12.4	+21.5
Norway (OSEAX)	477.2	-1.4	+7.9	+11.8
Poland (WIG)	43,825.9	+1.2	+16.6	+22.0
Russia (RTS, $ terms)	1,367.2	-4.2	-2.2	-1.1
Sweden (OMXS30)	1,052.2	-0.4	+6.5	+7.6
Switzerland (SMI)	6,677.0	-0.3	+12.5	+11.2
Turkey (ISE)	71,325.6	-0.4	+39.1	+45.5
Australia (All Ord.)	4,410.7	-2.7	+7.3	+8.9
Hong Kong (Hang Seng)	21,442.0	-3.0	+16.3	+16.6
India (BSE)	18,618.9	-1.5	+20.5	+16.4
Indonesia (JSX)	4,351.3	nil	+13.8	+7.2
Malaysia (KLSE)	1,631.7	-0.8	+6.6	+10.3
Pakistan (KSE)	16,120.5	-0.6	+42.1	+33.2
Singapore (STI)	2,978.0	-2.1	+12.5	+19.3
South Korea (KOSPI)	1,894.0	-2.2	+3.7	+10.2
Taiwan (TWI)	7,159.8	-1.7	+1.2	+5.6
Thailand (SET)	1,279.3	-1.6	+24.8	+28.2
Argentina (MERV)	2,320.7	-2.1	-5.8	-15.2
Brazil (BVSP)	56,279.4	-3.8	-0.8	-10.6
Chile (IGPA)	20,535.7	-1.6	+2.0	+9.3
Colombia (IGBC)	14,040.3	+0.5	+10.9	+18.2
Mexico (IPC)	40,750.4	-0.6	+9.9	+15.9
Venezuela (IBC)	372,840.0	+2.6	+219	na
Egypt (Case 30)	5,662.4	+1.4	+56.3	+54.5
Israel (TA-100)	1,054.1	-1.8	+6.4	+2.8
Saudi Arabia (Tadawul)	6,816.9	-1.8	+6.7	+6.7
South Africa (JSE AS)	37,241.8	-0.6	+16.4	+5.6

Global business barometer

Businesspeople around the world are less glum than they were three months ago, according to a quarterly *Economist/FT* survey of over 1,500 executives, conducted by the Economist Intelligence Unit. The balance of respondents who think the global economy will get better over those who think it will worsen rose from minus 25 percentage points in July to minus 11 in October. Sentiment improved in all regions except eastern Europe, but only in the Middle East and Africa have executives become bullish. Those in the chemicals industry and consumer goods are especially gloomy. But when it comes to corporate fashion they seem more relaxed: 46% of executives reckon the necktie will be worn less often next year.



Source: *The Economist/FT* survey

Other markets

	Index Nov 14th	% change on one week	Dec 31st 2011 in local currency	Dec 31st 2011 in $ terms
United States (S&P 500)	1,355.5	-2.8	+7.8	+7.8
United States (NAScomp)	2,846.8	-3.1	+9.3	+9.3
China (SSEB, $ terms)	219.5	-1.3	+0.9	+2.0
Japan (Topix)	722.4	-3.1	-0.9	-4.9
Europe (FTSEurofirst 300)	1,088.4	-1.0	+8.7	+6.6
World, dev'd (MSCI)	1,257.1	-2.5	+6.3	+6.3
Emerging markets (MSCI)	980.6	-2.7	+7.0	+7.0
World, all (MSCI)	318.6	-2.5	+6.4	+6.4
World bonds (Citigroup)	951.6	-0.1	+2.4	+2.4
EMBI+ (JPMorgan)	696.1	-0.2	+15.6	+15.6
Hedge funds (HFRX)	1,130.9§	-0.5	+1.9	+1.9
Volatility, US (VIX)	17.9	+19.1	+23.4	(levels)
CDSs, Eur (iTRAXX)†	131.6	+1.5	-25.2	-26.7
CDSs, N Am (CDX)†	108.5	+8.7	-16.9	-16.9
Carbon trading (EU ETS) €	7.9	-3.9	+10.6	+8.5

Sources: Bloomberg; CBOE; CBOT; CMIE; Cotlook; Darmenn & Curl; EEX; FT; HKMA; ICCO; ICO; ISO; Jackson Rice; JPMorgan Chase; Markit; NZ Wool Services; Thompson Lloyd & Ewart; Thomson Reuters; Urner Barry; WSJ; WM/Reuters. *Total return index. †Credit-default-swap spreads, basis points. §Nov 13th.

The Economist commodity-price index

2005=100

	Nov 6th	Nov 13th*	% change on one month	% change on one year
Dollar index				
All items	186.7	183.4	-2.8	-1.5
Food	220.8	214.3	-2.3	+3.0
Industrials				
All	151.3	151.3	-3.6	-7.4
Nfa†	156.3	154.5	-3.1	-15.1
Metals	149.1	149.9	-3.8	-3.5
Sterling index				
All items	212.5	209.9	-1.5	-1.9
Euro index				
All items	181.3	179.4	-0.4	+4.8
Gold				
$ per oz	1,693.3	1,728.3	-0.9	-2.9
West Texas Intermediate				
$ per barrel	88.4	85.3	-7.3	-14.3

*Provisional †Non-food agriculturals.

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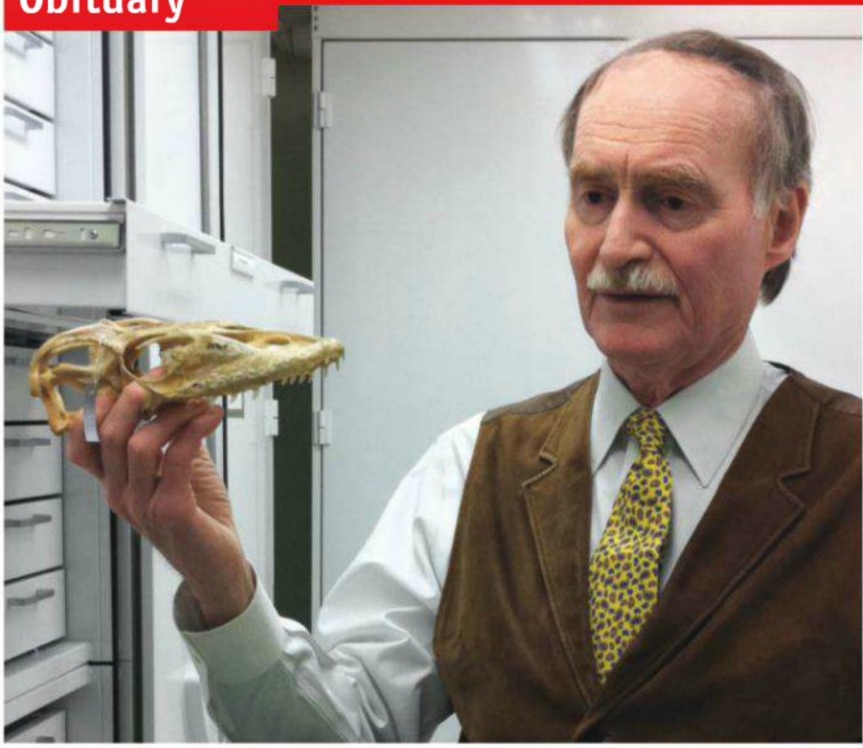

Farish Jenkins

Farish Jenkins, paleontologist and polymath, died on November 11th aged 72

INDIANA JONES is the ultimate action-hero academic: played by Harrison Ford, the indomitable professor outwits Nazis and other villains in search of religious relics, lost temples and alien artefacts. Farish Jenkins preferred a rifle to a bullwhip, and it was palaeontology, not archaeology, that he made glamorous. But he did have a stylish hat, a military background and adventures in wild places. His adoring students dubbed him the real life version of the cinematic creation.

A Marine Corps captain, he trained as an artillery officer, "cascading expensive, high explosive ordnance onto stockpiles of junk cars". Unlike most modern academics, he defied categorisation into narrow specialism. A "hybrid" as he put it, he was anatomist, zoologist and vertebrate palaeontologist in equal measure.

Arriving at Yale to study geology in 1964, he was told that all major aspects of vertebrate evolution were already understood. He feared that he and his friends would be left "to build our careers with carefully stacked minutiae". In fact, "titanic" discoveries awaited. But to crack the secrets of the fossil world, he had to master not only the rocks but the organisms they hid. He was the first Yale Graduate School student to cross over to the Medical School, to study anatomy and embryology.

Later, he illustrated his lectures with fine anatomical drawings, painstakingly rendered with what he proudly called Harvard's best collection of sharpened chalks (he was not a PowerPoint person). When necessary, he would draw bones and muscles on his own suit. To illustrate the body's natural shock-absorbers, he would stomp round the room on a peg leg, reading the description of Captain Ahab's gait in "Moby Dick". Students loved that, and how he timed his lectures to the second.

He had no time for academic squabbles and protocol, brushing off rebukes and bureaucratic constraints. Charm was his first weapon, obstinacy his second. It was not just his clothes and vocabulary that were old-fashioned. He prized thoroughness. Unusually for modern academia, he showered praise on colleagues and deprecated his own triumphs. But he was a mighty foe when roused. He could swear like a Marine, "without repeating myself" and helped oust the abrasive Larry Summers from the Harvard presidency.

The first field trip was to Africa, where his "very close and extremely naive encounters" with the local fauna included a self-portrait with a black rhino (plentiful as "rats in a dump" in those days). The beast took offence and charged; Mr Jenkins made it back to his car minus a lens cap. Living vertebrates, he decided, were just as interesting as their extinct relatives.

High speed cineradiography (making moving pictures from x-rays), plus treadmills and a wind tunnel gave him new insights into how animals move: walking, trotting, galloping, flying and brachiating (the way monkeys swing). His efforts reached, he said proudly, "circus-like" proportions. "Tree shrews ricocheted across my bookshelves and desk," he recalled. University bosses were appalled. His students and colleagues were captivated.

But fieldwork was even more fun. The most arduous expeditions were to east Greenland and arctic Canada, armed with lavatory paper to wrap the fossils, and chocolate bars for the diggers. Mr Jenkins was a distinctive addition to the landscape: invariably well-dressed, and sporting a beloved Czechoslovak rabbit-fur hat, a pocket-watch, a flask of vodka and a gun. He rigged trip wires and automatic rifle fire to deter polar bears from the camp at night. A cast of a huge paw print in his office was a souvenir of a particularly narrow escape.

The trophies of those trips were carefully chipped open at Harvard. One proved to be the great find of his life: *Tiktaalik roseae*. "Rose" was the Christian name of an anonymous benefactor who subsidised the expeditions. Tiktaalik was a homage to his Inuit hosts: their word for a large freshwater fish. In fossil-speak the discovery was "the elpistostegalian central to understanding the emergence of tetrapods". In layman's language, it was a 375m-year-old fish with legs, a rudimentary ear and a snout for catching prey—a vital clue to how living beings first moved from sea to land.

Smart man

Another big find was what he called the "ugliest animal in the world" (therefore named *Gerrothorax pulcherrimus*, or "most beautiful wicker chest"). It was a 210m-year-old armoured marine creature. Mr Jenkins spotted its distinguishing feature: that it opened its mouth by lifting its upper jaw. He was crucial in discovering the world's earliest known frog, which unlike its salamander-like ancestors had hind legs for jumping. He found that in 1981 in the Arizona desert. It initially looked like "road kill", his colleague Neil Shubin said: a 190m-year-old mash of four different frog skeletons. The two men spent the next 14 years picking them apart and putting them back together. They named their find *Prosalirus bitis*, combining a Latin word meaning "leap forward" with a Navajo word for "high above it".

After a bout of cancer he dismissed a visitor's worries, saying: "as a palaeontologist, I'm familiar with extinction." In his spare time he trapped the chipmunks that infested his barn and made prodigious quantities of cider from his own apples. ■

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